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Supreme Court, U.S.
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No. 02- 02-91

IN THE

Supreme Court of the United States

RONALD I. WEISS, Executor and Trustee for
WALTER L. ABT,

Petitioner,

v.

ST. PAUL FIRE & MARINE INSURANCE CO.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Respondent's law firm claimed to have created a docket system in which service of a federal court complaint was ignored until *after* a plaintiff filed a return of service. Respondent's law firm never provided any justification for the misconstruction for the rules governing when an answer to a complaint is due. For decades, courts have consistently ruled that ignorance of the law (in particular, unambiguous laws) is not excusable neglect. Rule 60(b)(1) has never served as a shelter for attorneys or parties who fail to act with due diligence. The failure to answer has been even less tolerated when there are no minimal safeguards established to ensure the timely filing of an answer. In direct conflict with *Pioneer Investment Services Co. v. Brunswick Associates Ltd. Partnership*, 507 U.S. 380 (1993) and the other circuits courts of appeal, the Sixth Circuit held that ignorance of unambiguous rules is merely an honest mistake that must be excusable under Rule 60(b)(1). As part of its ruling, the Sixth Circuit also imposed a new duty on plaintiff's counsel to ensure that defendant's counsel timely answers a complaint. To use Rule 60(b)(1) to circumvent the rules of service is both a perversion of the rule and its purpose.

The first series of related questions presented are: (a) Does ignorance of the rules constitute an honest mistake that must be excusable? (b) Is a default judgment caused by a law firm's docket system that deliberately ignores perfected service excusable as a mistake? (c) Does plaintiff's counsel have a duty to ensure that defendant's counsel does not miss the deadline for filing an answer?

2. The policy of the Rules of Decision Act is to secure uniformity of decisions within each state so that cases dependent upon state law will not be decided differently according to whether they are before federal or state courts. Under the Erie doctrine, state law as announced by the highest court of a state is to be followed by the federal courts sitting in a diversity action. A federal court of appeals does not have the power to reconsider interpretations of state law by state courts. In Ohio state courts, as held by the Ohio Supreme Court, the intent of the parties is irrelevant to the construction of an insurance contract. In the decision below, the Sixth Circuit followed Michigan insurance law and Ohio appellate law instead of the controlling precedent from the Ohio Supreme Court. This decision has now created an Ohio federal common law for the construction of insurance contracts, by ruling that in construing an insurance contract, a federal court is required to examine the intent of the parties.

The second question presented is whether a federal court can create its own common law for the construction of insurance contracts or is it bound by the controlling precedent from the highest court of the state?

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Petitioner respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit in this case.

OPINIONS BELOW

The district court's opinion (per White, D. J.) granting respondent's motion to vacate is unpublished. (Pet. App. 111a-117a). The magistrate judge's opinion (per Perelman, M.J.) granting in part and denying in part the parties' summary judgment motions is unpublished. (Pet. App. 46a-110a). The district court's opinion (per Wells, D.J.) granting in part and denying in part the parties' summary judgment motions is unpublished. (Pet. App. 18a-45a). The court of appeals' opinion (per Batchelder, C.J. joined by Kennedy and Keith, J.J.) reversing in part and affirming in part (Pet. App. 1a-17a) is published at 283 F.3d 790 (6th Cir. 2002).

STATEMENT OF JURISDICTION

The court of appeals entered its opinion and order on March 18, 2002. Justice Stevens subsequently extended the time to file this petition for a writ of certiorari to and including July 17, 2002. Petitioner invokes this Court's jurisdiction under 28 U.S.C. § 1254(1).

RULES INVOLVED

Rule 55(c) of the Federal Rules of Civil Procedure provides:

> For good cause shown the court may set aside an entry of default and, if a judgment by default has been entered, may likewise set it aside in accordance with Rule 60(b).

Rule 60(b) provides in pertinent part:

> On motion and upon such terms as are just, the court may relieve a party or a party's legal representative from a final judgment, order, or proceeding for the following reasons: (1) mistake, inadvertence, surprise, or excusable neglect; . . .

STATEMENT OF THE CASE

A. *General Background.*

Petitioner is the Executor and Trustee for the original Plaintiff, Walter L. Abt ("Abt") who died during the pendancy of the appeal. Abt was the controlling shareholder, Chairman of the Board and President of Mor-Flo Industries, Inc. ("Mor-Flo"). (R. 95 Exhibit A, Abt Affidavit, Apx. p. 688).

Mor-Flo was insured by Respondent insurance company. Respondent refused to provide Mor-Flo with either coverage or a defense in connection with a patent infringement lawsuit that had been filed against it. A judgment was awarded against Mor-Flo in that lawsuit.

In July 1992, Mor-Flo merged with another company. During the merger discussions, it was agreed that Mor-Flo could assign its claim against Respondent to Abt. (R. 95 Exhibit A, Abt Affidavit, Apx. p. 688).

B. *The Default Judgment.*

On August 25, 1992, Abt filed his Complaint against Respondent seeking, among other things, a declaration of Respondent's obligations under the applicable insurance policies.

It is undisputed that Respondent and its counsel knew that Respondent was served with the Complaint. (TR 43;

R. 12, Motion to Vacate, Apx. p. 314). Neither an answer nor other responsive pleading was timely filed. (R. 7 Motion for Entry of Default, Apx. p. 300). No explanation was provided by either Respondent or its counsel for that failure.

The affidavits and testimony presented at the default hearing established that Respondent's law firm created a docket system in which service of a federal court complaint was ignored until *after* a plaintiff filed a *return of service*. During the default hearing, one of the senior partners of the law firm was questioned by the district court. He admitted that there was no dispute that Respondent had been served and that his law firm possessed the Complaint. Nonetheless, no answer was filed:

> [Court:] A couple of things bother me in this case, counsel: One, it appears there is *no question about when the defendant received the complaint* or at least had the complaint. Am I right on that?
>
> [Law firm:] Are you right? *you are absolutely right*, your Honor.
>
> * * *
>
> I might say professionally in this instance that Mr. Baker [Respondent's attorney assigned to the case] actually instructed an associate of ours to prepare answers and that sort of thing *pending getting information* from the docket *that the service had been perfected*. [Emphasis added.]
>
> * * *
>
> [I]n this instance a mistake was made.

(TR 43-45).

In its decision, the Sixth Circuit reviewed the procedure utilized by Respondent's law firm for processing the Complaint. This revealed that the law firm supposedly established a procedure in which it would not answer a complaint until the return of service has been filed with the court:

> By August 27, 1992, St. Paul [Respondent] had received the complaint through certified mail. On September 2, 1992, St. Paul sent the complaint to Weston (St. Paul's counsel) which received the complaint in its docket department the following day. Dennis Kolibab, a docket clerk, *testified that pursuant to Weston's policy he called the district court clerk asking whether the return of service had been filed*. After finding that the return had not yet been filed, he docketed an answer date for September 14, twenty days from the date the complaint was filed. *The return of service was filed on September 9, 1992.*
>
> James Barone, another docket clerk at Weston, *stated in his affidavit that on September 12 or 13, 1992, [FN2] he called the district court to ascertain whether the return was filed*, and again was informed that the return had not yet been filed. Following Weston policy, Barone moved the answer date forward to September 24, 1992. This date was thirty days after the complaint was filed.
>
> FN2. Barone's recollection is flawed because September 12 was Saturday and the 13th was Sunday and on neither day was the clerk's office open.

> No answer to the complaint was filed by the answer date of September 16. Two days later a default was entered on the court's docket. On September 22, 1992, Abt filed an affidavit in support of a default judgment in which he alleged damages due to him of approximately fifteen million dollars. Around that date, *Barone again telephoned the district court clerk and inquired about the status of the return of service* and was again told that no return had yet been filed. (Apparently the court clerk did not mention that a default had been entered in the case.) Barone then noted a new, later, answer date of October 4, 1992. This date was forty days after the filing of the complaint.
>
> The court entered a default judgment on September 28, 1992. Weston's internal docket sheet indicated that on October 4, someone — Weston has not been able to determine who — postponed the answer date to October 18, 1992.

(Pet. App. 5a-7a).

The Sixth Circuit omitted several important facts concerning the docketing process: First, in their affidavits, no one from Respondent's law firm claimed to have called the district court's clerk on October 4 when the answer date was postponed until October 18, 1992. Otherwise, Respondent's law firm would have been forced to claim for *the third time* that the district court clerk provided the wrong information.[1]

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1. This is even more significant because of the questionable nature of the affidavits that were submitted to the district court. (Cont'd)

Second, the affidavits also show that four attorneys were assigned to this litigation when Respondent's law firm received the Complaint from Respondent. As set forth in the testimony above, those attorneys were working on an answer in anticipation of the filing of the Return of Service. (R. 12 Motion, Exhibit J, Apx. p. 397).

Respondent and Respondent's law firm never provided any justification for the misconstruction of the rules governing when an answer to a complaint is due. None of the four attorneys assigned to the case testified at the hearing. For that matter, Respondent and Respondent's law firm never expressly stated that they did not understand the rules regarding when an answer is due. Based on the purported reliance on the Return of Service, the district court inferred, perhaps, incorrectly, that the law firm did not understand the rules.

The district court properly ruled in its Order:

> There is nothing in the Federal Rules of Civil Procedure or Local Court Rules requiring the return of service to be filed within a certain time. It may be filed months later. Meanwhile, the time to answer will have expired.

(Pet. App. 115a).

(Cont'd)
As noted in the Sixth Circuit's opinion, Respondent's law firm claimed to have called the district court clerk on September 12 or 13, 1992 to determine whether the Return of Service had been filed. It has been unequivocally established that the telephone call could not have been made because September 12 was a Saturday and September 13 was a Sunday.

Not surprisingly, the district court did not (and could not) analyze in its Order why Respondent and Respondent's law firm did not respond to the Complaint when they knew and understood that service of the Complaint had been perfected. The Order addressed the issue of mistake in one sentence: "The law firm made a good faith effort to determine the date of service from the Clerk of Court, *apparently*, mistakenly relying on Plaintiff's Return of Service." (Emphasis added.) (Pet. App. 115a).

It is clear from this one cryptic sentence that the district court could not articulate the true nature of the mistake because no such evidence had been presented to it. The district court's use of the word "apparently" evidences that the district court recognized that Respondent and Respondent's law firm never identified the mistake that led to the default judgment. The district court made no effort to analyze the legal precedent regarding ignorance of the law as excusable neglect.

In affirming the district court, the Sixth Circuit bypassed the critical issue — that the return of service is irrelevant to the answer date. The Sixth Circuit sidestepped the legal precedent with respect to ignorance of the law. Instead, the Sixth Circuit stated: "St. Paul's counsel did not simply ignore the pleading deadlines, but repeatedly checked with the office of the district court clerk to determine whether service had been effected upon St. Paul and mistakenly relied upon the information obtained from the clerk." (Pet. App. 10a).

This ruling fails to address the question: Why was the law firm checking with the district court clerk when the law firm knew that Respondent had been served with the Complaint? This ruling fails to address the question:

What legal authority was unclear which caused the law firm to believe that is was necessary for it to call the district court clerk? This ruling overlooks any discussion of how the rules of service could be interpreted to support the law firm's "honest mistake."

It cannot be disputed that the rules for filing an answer are clear and unambiguous. Indeed, the summons that was served on Respondent (as well as all summonses) stated:

> YOU ARE HEREBY SUMMONED and required to file . . . an answer to the complaint which is herewith served upon you within 20 days after service of the summons upon you, exclusive of the day of service. *If you fail to do so, judgment by default will be taken against you for the relief demanded in the complaint.* [Emphasis added.]

(R. 6: Return of Service). Respondent's law firm made no effort to introduce *any evidence* showing the source of its confusion.

Moreover, in reaching its decision, the Sixth Circuit imposed new duties on future plaintiff's counsel. Those duties transcend the rules and appear to require plaintiff's counsel to ensure that a defendant timely files an answer.[2] The Sixth Circuit stated that Petitioner's argument was "somewhat disingenuous" because Petitioner's attorneys "had been in frequent touch" with Respondent's attorneys "prior to the initiation of this suit, but elected not to notify them of the

2. The district court considered the conduct of Petitioner's counsel, and ruled that Petitioner and its counsel acted within the rules: "[P]laintiff, . . . [acted] within the rules . . . in applying for default judgment." (Pet. App. 115a).

filing of the lawsuit, the entry of default or the default judgment." (Pet. App. 11a). In making this observation, the Sixth Circuit overlooked a number of salient facts that are undisputed in the record:

First, this is not a case in which the Complaint was lost or misplaced after service was achieved, causing an inability to locate the Complaint which, in turn, resulted in a default. Respondent and its law firm had the Complaint. How could "notifying them of the filing of the lawsuit" enhance their knowledge?

Second, Petitioner's counsel did not communicate with Respondent's counsel during the nine month period before the Complaint was filed. Respondent's counsel had only been retained "to render an opinion as to whether [Respondent] had a duty to indemnify Mor-Flo . . ." Significantly, Respondent's counsel, itself, did not know that it would represent Respondent in this litigation until *after* it received the Complaint. Respondent's law firm had to conduct a conflicts check upon receipt of the Complaint from Respondent before Respondent's law firm could agree to represent Respondent. (R. 12, Motion to Vacate at Affidavit of Gerlich, Exhibit J, Apx. p. 397; TR. 38). Thus, it is incredible to postulate that Petitioner's counsel should have known that Respondent's law firm would represent Respondent even though Respondent's law firm, itself, had not made and could not then make that determination.

Finally, the pre-lawsuit discussions are irrelevant. To be a party who has "appeared" in the case so as to be entitled to notice of application to the court for default judgment, the appearance must be responsive to plaintiff's formal court action, and the mere fact that plaintiff knows that defendant plans to contest the suit is insufficient. *Baez v. S.S. Kresge Company*, 518 F.2d 349 (5th Cir. 1975), *cert. denied*, 424 U.S. 904 (1976).

C. *Respondent's Duty to Defend and Indemnify.*

After the district court vacated the default judgment, the litigation proceeded. Mor-Flo's CGL Policy has a Broadening Endorsement that adds coverage for "advertising injury":

> *Personal Injury and Advertising Injury Coverage*
>
> We'll pay amounts you and other protected persons are legally required to pay as damages for covered personal injury or advertising injury claims resulting from your business activities.
>
> * * *
>
> **Advertising injury** means any of the following types of interference with someone's rights resulting from any advertisement, advertising or publicity article, broadcast or telecast.
>
> - libel, slander or defamation.
> - violation of the right of privacy.
> - ***piracy***.
> - unfair competition.
> - infringement of copyright, title or slogan. [Emphasis added.]

(R. 99 Exhibit D at 658, 659, Apx. p. 1590). The Excess Policy similarly contains advertising injury coverage. (R. 99 Exhibit E at 716-717, Apx. p. 1660).

The CGL Policy and the Excess Policy do not contain an exclusion for patent infringement. Nor do they define the term "piracy." (R. 95 Exhibit B, Admissions, Nos. 11, 13, 15, 17, 25-27, 29, Apx. p. 691).

Under its advertising injury coverage, Mor-Flo was entitled to coverage when: (1) a claim encompasses one of the enumerated offenses contained in the advertising injury provision (i.e., piracy); and (2) the injury or damage has some causal connection with advertising.

In reversing the district court's ruling that Respondent breached its duty to defend, the leading authority relied upon by the Sixth Circuit was *Herman Miller, Inc. v. The Travelers Indemnity Company*, 162 F.3d 454 (6th Cir. 1998). (Pet. App. 13a-16a). *Herman Miller* applied Michigan insurance law. The problems created by the decision below resulted from the Sixth Circuit mistakenly relying upon Michigan insurance case law and Ohio appellate case law instead of controlling Ohio Supreme Court precedent. The neglected Ohio Supreme Court precedent would have compelled a different outcome.

In *Herman Miller*, the court noted that "piracy" may "constitute patent infringement."[3] Notwithstanding this

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3. Under the relevant policy, "piracy" is not defined. If "piracy" means "patent infringement" then Respondent was obligated to provide coverage and a defense. The record is replete with evidence showing that Respondent, itself, believed that "piracy" could be interpreted to mean "patent infringement." For example, in 1990 Respondent openly acknowledged that its advertising injury provision had been interpreted to provide coverage for patent infringement claims. Respondent made that admission in a filing with the Ohio Department of Insurance when the offense of "piracy" was deleted from its coverage. (R. 96, Exhibit N, Apx. p. 948, 950).

possible meaning, the court decided against coverage stating that it was not the "parties' intention" to provide coverage:

> Viewed alone, we could not say that the term "piracy," . . . could never constitute patent infringement . . . There is not, however, any reference to patent infringement, [in the policy] although such mention could have been just as easily added *had that been the parties' intention*. [Emphasis added.]

Id. at 455.[4]

The Ohio Supreme Court has ruled that the intent of the parties is irrelevant to the construction of an insurance contract. In Ohio, when a word has multiple meanings, coverage is presumed unless there is an express exemption or qualification precluding the meaning in question. *Scott-Pontzer v. Liberty Mut. Fire Ins. Co.*, 85 Ohio St. 3d

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4. *Herman Miller* relied on *Advanced Watch Co. v. Kemper Nat'l Ins. Co.*, 99 F.3d 795 (6th Cir. 1996). *Advanced Watch* also applied Michigan insurance law and ruled against coverage after attempting to examine the intent of the parties: "[T]he only reasonable assumption is that if Travelers had intended to provide coverage for such liability, the insurer would have referred to it by name in the policy, as it did in the case of 'infringement of copyright, title or slogan.'" *Id.* at 803. In interpreting insurance contracts, Michigan recognizes the reasonable expectation doctrine. *Vanguard v. Clarke*, 438 Mich. 463 (1991). The reasonable expectation doctrine comprises an adjunct to the rules of construction of insurance contracts. *Id.* Ohio law has not adopted the reasonable expectation doctrine. *Park-Ohio Indus., Inc. v. Home Indem. Co.*, 975 F.2d 1215 (6th Cir. 1992); *Sterling Merchandise Co. v. Hartford Insurance Co.*, 30 Ohio App. 3d 131 (Summit Cty. 1986).

660, 665-666 (1999) (ruling that the word "you" was ambiguous). There, the Ohio Supreme Court explained:

> We realize that the conclusion reached herein may be viewed by some as *a result that was not intended by the parties* to the insurance contracts at issue. . . . In any event, as the law is clear in this regard, *we will not guess at the intent of the parties* to the insurance contract when the insurer introduces ambiguous terms into the policy. [Emphasis added.]

Id. at 666.

Thus, in applying *Scott-Pontzer* to the facts of our case, once it would be concluded that "piracy" may "constitute patent infringement," then no further analysis is performed and coverage would be presumed. In *Scott-Pontzer*, the Ohio Supreme Court explained (in direct contrast to *Herman Miller*) that "we will not guess at the intent of the parties." *Id.* at 666. Accordingly, the Ohio Supreme Court has expressly rejected Michigan law as adopted in *Herman Miller*.

Even though *Scott-Pontzer* was heavily cited in the briefs before the Sixth Circuit, the Sixth Circuit elected to ignore that decision. Instead, the Sixth Circuit relied upon *United National Ins. Co. v. SST Fitness Corp.*, 182 F.3d 447 (6th Cir. 1999) for the proposition that the rules of insurance contract interpretation under Ohio and Michigan law are the same. *Id.* at 796. This reliance was incorrect and misplaced.

In *SST Fitness*, the court does a pithy comparison of Ohio and Michigan insurance law. As part of its survey of Ohio law, the *SST Fitness* opinion cites *Watkins v. Brown*, 97 Ohio App. 3d 160 (Montgomery Cty. 1994) for the proposition that in interpreting an insurance contract a court should look to the "intention of the parties." *Id.* at 450.

To the extent that *Watkins* was ever a correct recitation of Ohio law, it is clear that *Scott-Pontzer* is the controlling Ohio authority. Under Ohio law the intention of the parties is irrelevant. Michigan and Ohio law diverge at this pivotal point.

It is this critical differentiation that distinguishes *Herman Miller* from Ohio law. The *Herman Miller* opinion is premised on a presumption antithetical to Ohio law. Under *Herman Miller*, once it was determined that "piracy" may mean "patent infringement," the court then proceeded to examine the intent of the parties. Under *Scott-Pontzer*, once it was determined that a word has more than one meaning, then coverage is presumed without regard to the intent of the parties. *Id.* at 666.[5]

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5. *Herman Miller*, itself, noted that "piracy" may be construed to mean patent infringement. BLACK'S LAW DICTIONARY states "piracy" is "applied to . . . the unlawful reproduction or distribution of property protected by patent . . . laws." *See* BLACK'S LAW DICTIONARY 1148 (6th Ed. 1990). This Court has defined "piracy" to include patent infringement. *Graver Tank & Mfg. Co. v. Linde Air Products Co.*, 339 U.S. 605, 607 (1950).

REASONS FOR GRANTING THE WRIT

I. The Decision Below Eviscerates The Excusable Neglect Requirement Contained In Rule 60(b)(1).

The Sixth Circuit's decision conflicts with the holdings of this Court and other circuits. It espouses the legal principles that: (a) ignorance of rules constitutes an honest mistake that must be excusable; (b) a default judgment caused by a law firm's docket system that deliberately ignores perfected service is excusable as a mistake, and (c) plaintiff's counsel should ensure that defendant's counsel does not miss the deadline for filing an answer.

A. *Under the Decision Below Ignorance of the Law is Excusable Neglect.*

The Sixth Circuit opinion stands for the unprecedented proposition that ignorance of the rules constitutes an honest mistake that must be excusable under Rule 60(b)(1): The Sixth Circuit ruled:

> St. Paul's counsel did not simply ignore the pleading deadlines, but repeatedly checked with the office of the district court clerk to determine whether service had been effected upon St. Paul and mistakenly relied upon the information obtained from the clerk. Neither St. Paul nor its counsel was willful in failing to respond timely, and the failure to file an answer timely resulted from an honest mistake.

(Pet. App. 10a).

The Sixth Circuit's decision simply cannot be reconciled with the precedent from this Court. This Court has never endorsed a rule by which attorneys and parties could disregard process or procedural rules without consequence. *See, e.g.*, *Taylor v. Freeland & Kronz*, 503 U.S. 638, 644 (1992) ("Deadlines may lead to unwelcome results, but they prompt parties to act and they produce finality"); *Carlisle v. United States*, 517 U.S. 416 (1996):

> If 1-day late filings are acceptable, 10-day late filings might be equally acceptable, and so on in a cascade of exceptions that would engulf the rule erected by the filing deadline; yet regardless of where the cutoff line is set, some individuals will always fall just on the other side of it.

Id. at 430.

In *Pioneer Investment Services Co. v. Brunswick Associates Ltd. Partnership*, 507 U.S. 380 (1993), this Court resolved the dispute among the circuits regarding the meaning of "excusable neglect" within the context of Bankruptcy Rule 9006(b).[6] In establishing an equitable test, this Court reviewed the case law interpreting "excusable neglect" in various federal rules. In doing so, this Court reaffirmed that "ignorance of the rules, or mistakes construing the rules do not usually constitute 'excusable' neglect . . ." *Id.* at 392.

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6. This Court did not state whether the liberal reading of "excusable neglect" should be extended to Rule 60(b)(1). Indeed, this Court justified its liberal interpretation of excusable neglect under Bankruptcy Rule 9006 by arguing that the policies underlying Chapter 11 and the bankruptcy rules require it. This Court acknowledged, however, that the different purpose of a Chapter 7 bankruptcy would preclude such a liberal construction of the rules governing its proceedings. *Id.* at 389.

This Court held that the attorney's failure to timely file a proof of claim was excusable because the notice containing the filing date contained a *dramatic ambiguity*:

> We do, however, consider significant that the notice of the bar date provided by the Bankruptcy Court in this case *was outside the ordinary course in bankruptcy cases*. As the Court of Appeals noted, ordinarily the bar date in a bankruptcy case should be prominently announced and accompanied by an explanation of its significance. See 943 F.2d, at 678. *We agree with the court that the "peculiar and inconspicuous placement of the bar date in a notice regarding a creditors['] meeting," without any indication of the significance of the bar date, left a "dramatic ambiguity" in the notification. Ibid.* [FN15] This is not to say, of course, that respondents' counsel was not remiss in failing to apprehend the notice. To be sure, were there any evidence of prejudice to petitioner or to judicial administration in this case, or any indication at all of bad faith, we could not say that the Bankruptcy Court abused its discretion in declining to find the neglect to be "excusable." In the absence of such a showing, however, *we conclude that the unusual form of notice employed in this case requires a finding that the neglect of respondents' counsel was, under all the circumstances, "excusable."* [Emphasis added.]

Id. at 398-399.

There is nothing ambiguous about when an answer must be filed under Rule 12 of the Federal Rules of Civil Procedure. Moreover, the summons even cautions a defendant that a default will be taken if an answer is not filed within 20 days after service. Thus, except for the rare situation, which is not present in this case, this Court has made it clear that it will not permit parties and their counsel to disregard process or procedural rules with impunity.

Other circuits (and past Sixth Circuit precedent) have repeatedly held that ignorance of the law is not excusable neglect.[7] The Sixth Circuit's unprecedented approach conflicts squarely with the Seventh Circuit ruling that reliance on the return of service for determining when an answer is due is unreasonable. *O'Brien v. R.J. O'Brien & Associates, Inc.*, 998 F.2d 1394 (7th Cir. 1993).

There, the court reasoned:

> In considering RJO's [defendant] March 1 Motion [to vacate], the district court was presented with a return of service indicating that RJO had been served over 17 months before the entry of default. RJO did not contest the return of service or offer any explanation for its failure to respond, but rather argued that its good faith reasonable belief it had not been served . . . In support of this argument, RJO submitted an affidavit of Kenneth Lodge, one of its

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7. The circuits are in conflict regarding whether the *Pioneer* "excusable neglect" test should apply to ignorance of the law as an excuse under Rule 60(b)(1). In this case (and in the Sixth Circuit case cited below) *Pioneer* was not mentioned. The *Pioneer* decision was also not mentioned in opinions from the Fifth Circuit and Seventh Circuit *infra*. However, it was applied in opinions from the Eighth Circuit and Second Circuit *infra*.

> attorneys, which stated that an attorney for co-defendant Sage had informed him that O'Brien [plaintiff] had filed a complaint against [defendants] RJO and Sage . . . After RJO told him it had not been served, Lodge called the Clerk of Court . . . to inquire as to the status of the suit and was told that . . . no proof of service on RJO had been filed. Diligently following the suit, Lodge subsequently called the Clerk again and verified that the return of service still had not been filed.
>
> *Even if these events resulted in RJO's honest belief that it had not been served, such a belief was unreasonable.* Rule 4(g) does not require the parties serving process to promptly file proof of service with the court, but it expressly states that "[f]ailure to make proof of service does not affect the validity of service." Fed. R. Civ. P. 4(g). *Because pursuant to Rule 4(g) RJO knew or should have known that O'Brien could neglect to file a return of service and yet proceed with the suit, RJO's belief that it had not been served, merely because a return of service had not been filed, was unreasonable. To excuse a party's failure to respond to a summons because proof of service had not been filed would fly in the face of the explicit directive of Rule 4(g) that the failure to promptly file a return of service shall not effect the validity of service.* . . . [T]he district court correctly held that when a party fails to timely respond to a summons after being served, that party's default will not be excused by the plaintiff's failure to file a return of service. [Emphasis added.]

Id. at 1402.

Both before and after *Pioneer*, courts have consistently ruled that ignorance of the law is not excusable neglect. *Edward H. Bohlin Co. v. Banning Co.*, 6 F.3d 350, 357 (5th Cir. 1993) ("Gross carelessness, ignorance of the rules, or ignorance of the law are insufficient basis for 60(b)(1) relief"); *Webb v. James*, 147 F.3d 617, 622 (7th Cir. 1998) (defendants attorneys' neglect to conduct any prior research into consequences of extending rule 68 offer of judgment was not excusable neglect); *Ceridian Corp. v. SCSC Corp.*, 212 F.3d 398, 402-405 (8th Cir. 2000) (failure to follow clear dictates of statute that required filing of motion within 20 days did not constitute excusable neglect); *FHC Equities, L.L.C. v. MBL Life Assurance Corp.*, 188 F.3d 678, 685 (6th Cir. 1999) ("In fact, a court would abuse its discretion if it were to reopen a case under Rule 60(b)(1) when the reason asserted as justified relief is one attributable solely to counsel's carelessness or misapprehension of the law or the applicable rules of court.") Failure to comply with procedural rules "may be excusable where the language of a rule is ambiguous or susceptible to multiple interpretations, or where an apparent conflict exists between two rules." *Canfield v. Van Atta Buick/GMC Truck, Inc.*, 127 F.3d 248, 250 (2d Cir. 1997), *cert. denied*, 522 U.S. 1117 (1998) (failure to comply with filing deadline imposed by local rule was not excusable where rule was unambiguous and attorney had been informed by opposing counsel of rule's requirements).

In *Ceridian Corp.*, *supra*, the Eighth Circuit explained:

> *Pioneer* did not alter the traditional rule that mistakes of law do not constitute excusable neglect:
>
> > Soon after *Pioneer*, it was established [in the Eleventh Circuit] that attorney error

> based on a misunderstanding of the law was an insufficient basis for excusing a failure to comply with a deadline. And, no circuit that has considered the issue after *Pioneer* has held that an attorney's failure to grasp the relevant procedural law is "excusable neglect."
>
> *Advanced Estimating Sys., Inc. v. Riney*, 130 F.3d 996, 998 (11th Cir. 1997) (citation omitted) (citing cases from 2d, 5th, 7th, and 9th, Circuits); *see also Webb v. James*, 147 F.3d 617, 622 (7th Cir. 1998) (attorney's failure to conduct research not excusable neglect); *Mendell v. Gollust*, 909 F.2d 724, 731 (2d Cir. 1990), *aff'd on other grounds*, 501 U.S. 115, 111 S.Ct. 2173, 115 L.Ed.2d 109 (1991) (counsel's ignorance of the law did not mandate relief from judgment).

Id. at 404.

Rule 60(b)(1) has never served as a shelter for attorneys or parties who fail to act with due diligence. To permit the decision below to stand would create precedent that is both undesirable and unsettling to as well as in direct contravention of the policies inherent to the American legal system.

B. *Deliberate Procedures that Result in Default are an Honest Mistake.*

The conduct of Respondent and its law firm goes far beyond their purported ignorance of the law. Respondent's law firm set forth evidence showing that it *deliberately* set

up a docket system that ignores perfected service of process until the return of service is filed. There was no testimony explaining why the docket system was set up in this fashion. It is unfathomable that Respondent's law firm created such a docket system. Incredibly, the Sixth Circuit's decision rewarded this creative approach by ruling that "counsel did not simply ignore the pleading deadlines . . ." *Id.* at 795.

The failure to answer should be even less tolerated when attorneys actually design a system without regard to the unambiguous rules. Circuit courts have consistently found no excusable neglect for far less misconduct. *See, e.g., Direct Mail Specialists, Inc. v. Eclate Computerized Technologies, Inc.*, 840 F.2d 685, 690 (9th Cir. 1988) (when a defendant "has received actual or constructive notice of the filing of the action and failed to answer" his conduct is culpable . . . Mr. Bujkovsky [defendant], as a lawyer, presumably was well aware of the dangers of ignoring service of process); *Meadows v. Dominican Republic*, 817 F.2d 517, 521 (9th Cir. 1987) (a defendant's conduct is culpable if he has received actual or constructive notice of the filing of the action and failed to answer); *North Cent. Illinois Laborers' Dist. Council v. S.J. Groves & Sons, Inc.*, 842 F.2d 164 (7th Cir. 1988) (as a result of a filing or clerical error, defendant's in-house legal staff overlooked the complaint and failed to file an answer, default judgment was entered, the court ruled that this conduct did not constitute excusable neglect because the events contributing to the default judgment were within the "meaningful control" of the defendant); *Rogers v. Hartford Life and Accident Ins. Co.*, 167 F.3d 933, 938-939 (5th Cir. 1999) (defendant corporation's failure to respond to complaint was not excusable neglect, even though complaint had been lost by commercial courier that was supposed to deliver it from defendant's agent to defendant's claims office; defendant took no steps to establish minimum

internal procedural safeguards to ensure receipt of complaint, and when complaint was not delivered, defendant never attempted to obtain another copy of it); *Gibbs v. Air Canada*, 810 F.2d 1529 (11th Cir. 1987) (defendant company received complaint and sent it through its intercompany mail to its in-house counsel, the complaint was never received, default judgment was entered, and the court ruled that this did not constitute excusable neglect because defendant failed to establish minimal procedural safeguards).

The Sixth Circuit did not follow the well-settled principle that deliberate misconduct cannot be excusable. If courts extend relief in cases concerning carelessness or negligence, they have difficulty in ever drawing the line of finality again. Courts should not reopen judgments simply because the movant so requests.

C. *The New Duty to Provide Notice.*

The Sixth Circuit's suggestion that Petitioner's counsel should have notified Respondent's law firm is also unprecedented. The Sixth Circuit does not (and cannot) cite any authority for this proposition. Under the uncontroverted controlling authority, Respondent would have had to commit an affirmative act on its own behalf in this litigation *after* the filing of the Complaint to constitute an appearance which would have entitled it to notice before the default judgment.

A party only appears in an action when the party has actually made some presentation or submission to the district court in the pending action. *Zuelzke Tool & Eng. v. Anderson Die Castings*, 925 F.2d 226 (7th Cir. 1991) ("[I]t is a disservice to the legal system to distort the meaning of a concrete term such as 'appearance' in order to provide a

mechanism to save a party from a default judgment." *Id.* at 230.). "Normally, appearance in an action involves some presentation or submission to the Court." *Port-Wide Container Company v. Interstate Maintenance Corporation*, 440 F.2d 1195, 1196 (3d Cir. 1971). Moreover, the action that the Sixth Circuit suggests would have been an ethical violation of DR 7-101(A)(1) of the Code of Professional Responsibilities for failing to represent a client zealously.

The Sixth Circuit's decision reads the word "excusable" such that it is no longer a prerequisite of or relevant to Rule 60(b)(1). Such an interpretation of the rule is in direct conflict with the decisions of this Court and of other circuit courts of appeal. Those decisions make it clear that Rule 60(b)(1) is not a license for parties and their counsel to disregard process or procedural rules with impunity or to fail to exercise due diligence in regard to litigation. To condone such conduct makes a mockery of Rule 60(b)(1) and defeats other policies such as ensuring finality of judgments, promoting judicial efficiency and deterring inappropriate behavior. Therefore, this case merits review and reversal by this Court.

II. The Decision Below Has Created A Distinct Ohio Federal Common Law For The Construction Of Insurance Contracts.

In direct contravention to the Rules of Decision Act, 28 U.S.C. § 1652 and this Court's longstanding precedent, the Sixth Circuit applied Michigan law and Ohio appellate law instead of the controlling precedent from the Ohio Supreme Court. Ohio now has two sets of law for the construction of insurance contracts.

The policy of the Rules of Decision Act is to secure uniformity of decisions within each state so that cases dependent upon state law will not be decided differently according to whether they are before federal or state courts. *King v. Order of Commercial Travelers of America*, 333 U.S. 153, 157-158 (1948). Under the Erie doctrine state law as announced by the highest court of a state is to be followed by the federal court sitting in a diversity case. *Commissioner of Internal Revenue v. Estate of Bosch*, 387 U.S. 456 (1967). A federal court of appeals does not have power to reconsider interpretations of state law by state courts. *Bradley v. General Motors Corporation*, 512 F.2d 602 (6th Cir. 1975).

It is inexplicable that the Sixth Circuit elected to ignore the *Scott-Pontzer* Ohio Supreme Court decision in favor of Ohio appellate law and Michigan law. The Sixth Circuit holding has created new Ohio law. This will result in the precise type of forum-shopping that the Erie doctrine sought to end, thus meriting review and reversal by this Court.

CONCLUSION

For the foregoing reasons, the Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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APPENDIX

APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT DECIDED AND FILED MARCH 18, 2002

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Nos. 00-3267/3297

RONALD I. WEISS, Executor and Trustee for Plaintiff Walter L. Abt,

Plaintiff-Appellee/ Cross-Appellant,

v.

ST. PAUL FIRE AND MARINE INSURANCE COMPANY,

Defendant-Appellant/ Cross-Appellee.

Appeal from the United States District Court for the Northern District of Ohio at Cleveland. No. 92-01747—Lesley Brooks Wells, District Judge.

Argued: October 31, 2001

Decided and Filed: March 18, 2002

Before: KEITH, KENNEDY, and BATCHELDER, Circuit Judges.

OPINION

ALICE M. BATCHELDER, Circuit Judge. St. Paul Fire and Marine Insurance Company ("St. Paul") appeals the

judgment of the district court holding that it owed its insured, Mor-Flo Industries, Inc. ("Mor-Flo"), a duty to defend in a patent infringement action and that it was liable for the attorney's fees and costs incurred by Mor-Flo in defending that action. Ronald Weiss appeals the district court's order vacating Weiss's default judgment against St. Paul and the district court's judgment that St. Paul had no duty to indemnify Mor-Flo for the judgment against it in the patent infringement action. We will affirm the order vacating the default judgment and the judgment in favor of St. Paul on the issue of indemnification. We will reverse the district court's judgment in favor of Mor-Flo on the issue of St. Paul's duty to defend and the award of fees and costs.

I. Procedural Background

St. Paul provided liability coverage for Mor-Flo, a manufacturer of water heaters. In 1984, Mor-Flo was sued for patent infringement and St. Paul declined to defend, contending that it had no duty either to defend or indemnify. Mor-Flo lost the patent infringement suit and paid the patent holder $9,925,638.00 in damages and $2,250,158.24 in fees and costs. In 1992, Mor-Flo was sold and its former chairman, Walter L. Abt, purchased the rights to Mor-Flo's duty-to-defend claim against St. Paul for $1000.00.

Abt filed this action against St. Paul, seeking a declaratory judgment that St. Paul had a duty to defend Mor-Flo in the patent infringement action and a duty to indemnify Mor-Flo for the judgment against it in that action. Due to the failure of St. Paul and its outside counsel to file an answer, a default judgment was entered against St. Paul. The district

court granted St. Paul's motion to vacate the default judgment pursuant to Rule 60(b), and both parties then moved for summary judgment. The district court held that St. Paul had a duty to defend Mor-Flo in the patent litigation but did not have a duty to indemnify. The district court further found that, having breached its duty to defend Mor-Flo in the patent litigation suit, St. Paul was liable for the reasonable attorney's fees and costs incurred by Mor-Flo in defending that action. The court awarded prejudgment interest from the date of the conclusion of the patent litigation. This timely appeal followed.[1]

II. Facts

In 1979, State Industries, a manufacturer of water heaters, applied for a patent to cover its new process for making water heaters that used foam insulation as opposed to the prior industry standard of fiber glass insulation. Shortly thereafter, Mor-Flo developed its own foam-insulated water heater, using a slight variation of State's design, and by 1981, Mor-Flo was producing foam insulated heaters. By 1984, Mor-Flo was one of the largest water heater manufacturers in the nation.

On May 8, 1984, the Patent Office granted State a patent on State's method of manufacturing foam insulated heaters. State immediately sued Mor-Flo for patent infringement. Relying on the advice of patent counsel, Mor-Flo contested

1. After the notices of appeal were filed, Walter Abt died and Ronald Weiss, Abt's executor and trustee, was substituted as the plaintiff-appellee, cross-appellant. For ease of reference, we will continue to refer to the plaintiff as Abt.

the suit and continued to produce foam insulated water heaters. The district court ruled that Mor-Flo had infringed State's patent and that judgment was affirmed. The district court awarded State approximately $8.7 million in damages. By January 26, 1990, Mor-Flo had paid State a total of $9,925,638.00 in damages and had also paid $2,250,158.24 in fees and costs.

When the patent litigation began, Mor-Flo had three insurance policies through St. Paul. The Comprehensive General Liability plan provided coverage for "advertising injury claims resulting from your business activities." Advertising injury was defined as "Piracy; Unfair competition; Infringement of copyright, title or slogan" that resulted in interference with another's rights. Advertising claims that were the result of "infringement of trademark, service mark or trade name" were excluded from coverage. Another policy, the Umbrella Excess Liability plan, covered essentially the same activities in relation to advertising injuries. The third policy was a Director's and Officer's Liability plan.

In May of 1985, Mor-Flo requested that St. Paul defend the patent action and indemnify any losses. The St. Paul adjuster assigned to determine whether there was coverage inexplicably (even according to St. Paul itself) limited his review to Mor-Flo's Director's and Officer's Liability plan. Based on its review of only the Director's and Officer's Liability plan, St. Paul denied coverage.

Walter Abt was the chairman of the board, chief executive officer and majority shareholder of Mor-Flo. In February, 1991, Abt read an article in the *Wall Street Journal* that suggested that advertising injury provisions in comprehensive insurance plans

such as Mor-Flo's covered patent infringement litigation. Armed with this information, Abt submitted a claim to St. Paul. On April 25, 1991, St. Paul began its investigation into possible coverage for legal fees expended by Mor-Flo in the patent litigation. In July, Jacqueline McCroskey, the St. Paul claim representative at the Cleveland office assigned to Mor-Flo's claim, established an expense reserve of $1 million based on her belief that there was a fifty percent likelihood that St. Paul could be found liable for the approximately $2 million in legal fees accrued by Mor-Flo in defending the patent litigation. On September 27, 1991, St. Paul received an opinion from outside counsel that St. Paul had no duty to defend, and on October 2, 1991, McCroskey recommended that St. Paul issue a letter to Mor-Flo denying any duty to defend. On November 7, 1991, McCroskey sent a denial letter to Mor-Flo. Throughout this period, St. Paul's counsel and counsel for Mor-Flo corresponded by letter and telephone with regard to whether the St. Paul policies provided coverage for the patent infringement claim or required St. Paul to defend the patent litigation.

Mor-Flo was sold to SABH (US), Inc., during the spring of 1992, and Abt purchased the rights to Mor-Flo's duty-to-defend claim against St. Paul for $1000. Abt filed this declaratory judgment action on August 25, 1992. By August 27, 1992, St. Paul had received the complaint through certified mail. On September 2, 1992, St. Paul sent the complaint to Weston (St. Paul's counsel) which received the complaint in its docket department the following day. Dennis Kolibab, a docket clerk, testified that pursuant to Weston's policy he called the district court clerk asking whether the

return of service had been filed. After finding that the return had not yet been filed, he docketed an answer date for September 14, twenty days from the date the complaint was filed. The return of service was filed on September 9, 1992.

James Barone, another docket clerk at Weston, stated in his affidavit that on September 12 or 13, 1992,[2] he called the district court clerk to ascertain whether the return was filed, and again was informed that the return had not yet been filed. Following Weston policy, Barone moved the answer date forward to September 24, 1992. This date was thirty days after the complaint was filed.

No answer to the complaint was filed by the answer date of September 16. Two days later a default was entered on the court's docket. On September 22, 1992, Abt filed an affidavit in support of a default judgment in which he alleged damages due to him of approximately fifteen million dollars. Around that date, Barone again telephoned the district court clerk and inquired about the status of the return of service and was again told that no return had yet been filed. (Apparently the court clerk did not mention that a default had been entered in the case.) Barone then noted a new, later, answer date of October 4, 1992. This date was forty days after the filing of the complaint.

The court entered a default judgment on September 28, 1992. Weston's internal docket sheet indicated that on October 4, someone — Weston has not been able to determine

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2. Barone's recollection is flawed because September 12 was Saturday and the 13th was Sunday and on neither day was the clerk's office open.

who — postponed the answer date to October 18, 1992. Finally, on October 7, 1992, Weston learned of the default. The following day St. Paul filed a motion to vacate the default judgment pursuant to Federal Rule of Civil Procedure 60(b)(1) and (3).

The district court granted the motion finding that Abt was not prejudiced by the vacating of the judgment, St. Paul had a meritorious defense, there was no culpable conduct on St. Paul's behalf, and Abt's counsel knew of, but did not notify, St. Paul's counsel before obtaining the judgment. Each party then moved for summary judgment. The district court held that at the time the patent suit was filed in 1984 it was arguable whether Mor-Flo's policies covered its claim, and therefore, under *Willoughby Hills v. Cincinnati Ins. Co.*, 459 N.E.2d 555 (Ohio 1984), St. Paul had a duty to defend.

Next, relying on *Herman Miller, Inc. v. Travelers Indem. Co.*, 162 F.3d 454 (6th Cir. 1998), the court ruled that St. Paul did not have a duty to indemnify Mor-Flo because the plain meaning of "piracy" and "unfair competition" did not include a claim of patent infringement. On the issue of damages the district court found that, based on its breach of the duty to defend, St. Paul was liable to Mor-Flo for reasonable attorney's fees and costs incurred in the underlying patent infringement action and in this declaratory judgment action and for pre-judgment interest at Ohio's statutory rate from November 14, 1991, the date the parties stipulated as the conclusion of the underlying patent litigation.

Appendix A

III. Analysis

A. The Default Judgment

We review for abuse of discretion the district court's granting of a motion to vacate a default judgment. *Manufacturers' Indus. Relations Ass'n v. East Akron Casting Co.*, 58 F.3d 204, 207 (6th Cir. 1995). We review a motion to vacate a default judgment under the stricter standards of Rule 60(b) rather than under the more lax standards governing a motion to vacate the entry of default under Rule 55(c). *Waifersong, Ltd. Inc. v. Classic Music Vending*, 976 F.2d 290, 292 (6th Cir. 1992) ("But once the court has determined damages and a judgment has been entered, the district court's discretion to vacate the judgment is circumscribed by public policy favoring finality of judgments and termination of litigation. Rule 60(b) reflects this public policy by requiring greater specificity from a moving party before a court will set aside a default judgment.").

The Federal Rules of Civil Procedure require a defendant to serve an answer within twenty days of being served with a summons and complaint. Fed. R. Civ. P. 12(a)(1)(A). Rule 55 permits the clerk to enter a default when a party fails to defend an action as required. The court may then enter a default judgment. Fed. R. Civ. P. 55(b)(1). A party against whom a default judgment has been entered may petition the court to set aside the default judgment under Rules 55(c) and 60(b) for good cause, and upon a showing of mistake, or any other just reason.

Appendix A

The seminal case in this circuit on Rule 60(b) motions to vacate default judgments is *United Coin Meter Co., Inc. v. Seaboard Coastline R.R.*, 705 F.2d 839 (6th Cir. 1983). In *United Coin Meter* we noted that Rule 60(b) is to be applied "equitably and liberally" in considering motions to vacate defaults and default judgments, *id.* at 845, and that the same factors that control a motion to vacate an entry of default under Rule 55(c) are also applicable in determining whether to vacate a default judgment: (1) whether the opposing party would be prejudiced; (2) whether the proponent had a meritorious claim or defense; and (3) whether the proponent's culpable conduct led to the default. *Id.*

In *Waifersong*, we made it clear that a party seeking to vacate a default judgment under Rule 60(b)(1) must demonstrate first and foremost that the default did not result from his culpable conduct. That burden may be carried, we said, only by meeting the requirements of Rule 60(b)(1), that is, by "demonstrat[ing] that his default was the product of mistake, inadvertence, surprise, or excusable neglect." *Waifersong*, 976 F.2d at 292. Only if the moving party makes this showing may the district court proceed to consider the other *United Coin Meter* factors. *Id.* Other cases have affirmed the more stringent inquiry courts must pursue when vacating a default judgment as opposed to an entry of default. *See, e.g., Manufacturers' Indus. Relations Ass'n*, 58 F.3d at 208.

We recognize that the district court did not consider the *United Coin Meter* factors in the order that *Waifersong* requires. Nonetheless, although the court did not consider first whether St. Paul had demonstrated that the default was not due to its culpable conduct, the court's finding on that issue is clearly

sufficient to support its considering the other two factors. First, St. Paul demonstrated that its default was not the result of culpable conduct, but of mistake or, at worst, excusable neglect. St. Paul's counsel did not simply ignore the pleading deadlines, but repeatedly checked with the office of the district court clerk to determine whether service had been effected upon St. Paul and mistakenly relied upon the information obtained from the clerk. Neither St. Paul nor its counsel was willful in failing to respond timely, and the failure to file an answer timely resulted from an honest mistake. *See United Coin Meter Co., Inc.*, 705 F.2d at 845 (internal quotations omitted) ("Where default results from an honest mistake rather than willful misconduct, carelessness or negligence there is especial need to apply Rule 60(b) liberally."). Second, as we shall develop more fully below, St. Paul had a meritorious defense. And third, Abt was not prejudiced by the vacation of the default judgment. St. Paul moved to vacate this judgment immediately upon discovering the default, and that motion was filed less than 30 days after the date the answer to the complaint was due. We have often reiterated the principle that "trials on the merits are favored in federal courts," *id.* at 846, and that "any doubt should be resolved in favor of the petition to set aside the judgment so that cases may be decided on their merits." *Id.* (internal quotations and citations omitted) (quoting *Rooks v. Am. Brass Co.*, 263 F.2d 166, 169 (6th Cir. 1959)). We have therefore held that "mere delay in satisfying a plaintiff's claim, if it should succeed at trial, is not sufficient prejudice to require denial of a motion to set aside a default judgment." *Id.*

In fact, Abt's arguments are somewhat disingenuous. As the district court pointed out, Abt's attorneys had been in frequent touch with St. Paul's attorneys prior to the initiation of this suit, but elected not to notify them of the filing of the lawsuit, the entry of default or the default judgment. This is clearly not one of those "most extreme cases" where the default judgment is the result of deliberate, willful, conduct. *United Coin Meter Co., Inc.*, 705 F.2d at 845. Instead, this case presents an appropriate instance for the district court to exercise its discretion to "achieve substantial justice" through the liberal application of Rule 60(b). *Blois v. Friday*, 612 F.2d 938, 940 (5th Cir. 1980). We hold that the district court did not abuse its discretion in vacating the default judgment.

B. Summary Judgment on the Duty to Defend

We review a district court's grant of summary judgment de novo. *Advance Watch Co., Ltd. v. Kemper Nat'l Ins. Co.*, 99 F.3d 795, 799 (6th Cir. 1996). Summary judgment is appropriate if the evidence, taken in the light most favorable to the non-moving party, establishes that there is no genuine issue of material fact and that the moving party is entitled to judgment as a matter of law. Fed. R. Civ. Pro. 56(c). Here, the facts regarding the issue of a duty to defend are not in dispute.

St. Paul and Abt agree that *Willoughby Hills*, 459 N.E.2d at 555, controls this case. St. Paul claims that *Willoughby Hills* requires a factual analysis of the pleadings at the time the case was initiated to determine whether the facts alleged stated a claim that was "arguably" covered by the insurance policy. St. Paul further argues that Ohio courts have found,

since 1984 when the underlying patent suit was filed, that a patent infringement claim is not an "advertising injury" within the meaning of the policy in question, and this fact mandates the finding that a patent suit is not "arguably" an "advertising injury."

Abt, on the other hand, contends that this court must look to the legal landscape when the patent suit was initiated to determine whether arguably there was coverage, and that St. Paul's reliance on cases decided after the patent litigation began is misplaced. Abt argues that in jurisdictions other than Ohio legal opinion was divided in 1984 over whether a patent infringement claim was covered as an "advertising injury;" in essence, Abt argues that this division of opinion makes the coverage "arguable" under *Willoughby Hills*.

In *Willoughby Hills* the Supreme Court of Ohio addressed the changes wrought by Ohio's use of notice-pleading and expanded upon the earlier rule that a duty to defend may arise solely from the pleadings. Since under notice-pleading the duty to defend could arise at some point subsequent to the filing of the complaint, the court adopted the rule that when the pleadings "state a claim which is potentially or *arguably* within the policy coverage . . . the insurer must accept the defense of the claim." *Id.* at 558 (emphasis added). We agree that *Willoughby Hills* controls here, and we think that case requires that we determine from the plain meaning of the contract terms whether the occurrence is arguably covered by the insurance contract.

In Ohio, normal contract rules apply to the interpretation of insurance contracts. *King v. Nationwide Ins. Co.*, 519

N.E.2d 1380, 1383 (Ohio 1988). The court determines whether contract terms are ambiguous. *United Nat'l Ins. Co. v. SST Fitness Corp.*, 182 F.3d 447, 449 (6th Cir. 1999). A term is ambiguous if it is reasonably susceptible of more than one meaning. *King*, 519 N.E.2d at 1383. If the terms of the contract are unambiguous the court determines the meaning of the contract. *Nationwide Mut. Fire Ins. Co. v. Guman Bros. Farm*, 652 N.E.2d 684, 686 (Ohio 1995). The court is to give the terms of the contract their plain and natural meaning. *King*, 519 N.E.2d at 1383.

This court faced a situation similar to the one at hand in *Herman Miller*, 162 F.3d at 454, a case arising under Michigan law.[3] There, Herman Miller claimed that Travelers was required to defend it in a patent infringement action. *Id.* We held that patent infringement was not *arguably* covered as an "advertising injury" under either "piracy" or "unfair competition." *Id.* at 455. We conceded that piracy and unfair competition, in the abstract, might be construed broadly as encompassing patent infringement, but we concluded that since the policy specifically covered copyright infringement as an advertising injury, the omission of any reference to patent infringement as an advertising injury was an indication of the parties' intent. *Id.* The natural usage of the terms "piracy" and "patent infringement" also counseled us to assume that if the parties had desired to include coverage for

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3. Because Ohio and Michigan follow the same rules of contract construction, the *Herman Miller* analysis is applicable in this case. *See United Nat'l Ins. Co. v. SST Fitness Corp.*, 182 F.3d 447, 451 (6th Cir. 1999) (rejecting an attempt by a party to distinguish Ohio and Michigan law finding that "each state's rules of contract interpretation are the same").

patent infringement they would have included it specifically. *Id.* The court found that the terms of the policy did not encompass patent infringement and Travelers did not have an "arguable" duty to defend.

It is true that the *Herman Miller* case was decided years after the conclusion of the underlying patent litigation at issue here. But in that case we did not look to other jurisdictions to determine whether similar terms in insurance policies had been interpreted differently there. Our use in *Herman Miller* of traditional methods of contract interpretation to determine the plain meaning of the policy's terms bolsters St. Paul's position here. We think the *Herman Miller* approach is the correct one, and we conclude that the terms of the insurance contract at issue here were not made ambiguous by the lack of an authoritative or controlling legal interpretation of those terms. Furthermore, we have held that the approach advocated by Abt — that a contract provision is ambiguous as a matter of law if other jurisdictions have conflicting interpretations of similar provisions — is not the law in Ohio. *Park-Ohio Indus., Inc. v. Home Indem. Co.*, 975 F.2d 1215, 1220 (6th Cir. 1992) (italics in original) (internal citations omitted) ("The Supreme Court of Ohio has held that '[w]hen the language of an insurance policy has a plain and ordinary meaning, it is unnecessary and impermissible for this court to resort to construction of that language.' If we were to accept plaintiffs' argument that a contract provision is ambiguous *as a matter of law* because other jurisdictions have chosen to apply a provision differently, then we would be rejecting a well-settled Ohio rule of construction to apply the plain language of the contract where that language is clear and unambiguous.").

Appendix A

Our view that the plain meaning of the contract terms at issue here precludes a finding that claims for patent infringement are covered, arguably or otherwise, by the St. Paul policies is supported, however, by both Ohio and Sixth Circuit case law. Prior to our decision in *Herman Miller*, the Ninth District Court of Appeals of Ohio gave a restrictive interpretation to the term "advertising injury" in the case of *Synergystex Int'l, Inc. v. Motorists Mut. Ins.*, No. 2290-M, 1994 WL 395626 (Ohio Ct. App. July 27, 1994) (unpublished). In *Synergystex* the court found that the terms at issue — "Infringement of copyright, title or slogan" — were not ambiguous and without the prerequisite pleading of an injury caused by advertising, no coverage of a patent infringement claim was arguable. *Id.* at *3.

This circuit addressed the question of whether patent infringement is covered as an advertising injury in *United Nat'l Ins. Co.*, 182 F.3d at 449. Following the lead of *Synergystex*, we held that an advertising injury does not occur during the course of patent infringement unless the injury results directly from advertising. *Id.* at 450-51. Since SST only alleged an advertising injury that was in reality a patent infringement claim, the court found that there was no duty to defend. *Id.* at 451. Similarly, the complaint filed by State Industries against Mor-Flo — the complaint as to which Abt now claims St. Paul was obligated to provide Mor-Flo a defense — does not allege any injury directly resulting from advertising; rather, that complaint alleges patent infringement.

In *Advance Watch Co., Ltd.*, 99 F.3d at 799, a case involving claims of trademark infringement rather than patent

infringement, we found neither coverage nor a duty to defend. We held that the meaning of "advertising injury" was unambiguous because the terms in question had "either an established dictionary meaning or a meaning derived from case law." *Id.* at 802. We distinguished an advertising injury from trademark infringement in numerous ways. First, we noted that a trademark claim, unlike an advertising injury, does not depend on harmful speech, but instead is concerned solely with the design or appearance of a product. *Id.* at 803. Second, we found that because trademark infringement is commonly understood to be a distinct form of actionable conduct, the absence of an explicit reference to trademark infringement in a context in which such a reference would be expected pointed towards an exclusion of trademark litigation from coverage. *Id.* Finally, we found that the claimant had failed to allege a nexus between his trademark infringement claim and any advertising activity at all. *Id.* at 806.

We hold that the district court erred in concluding that because of the split in legal authority in 1984 in jurisdictions outside of Ohio, there was no way to determine what construction of the terms in question the Ohio courts would give. The plain meaning of an "advertising injury" defined in the policy as "piracy" and "unfair competition" does not arguably cover the losses due to patent litigation, and therefore St. Paul had no duty to defend Mor-Flo in the patent infringement litigation. And because we have held that St. Paul had no duty to defend, we will reverse the district court's judgment awarding attorney's fees and costs. The district court, sitting in diversity, was bound to apply the substantive law of Ohio. *Erie R.R. Co. v. Tompkins*, 304

U.S. 64 (1938); *Hayes v. Equitable Energy Res. Co.*, 266 F.3d 560, 566 (6th Cir. 2001). Ohio law does not permit a court to award attorney's fees in a declaratory judgment action except with explicit statutory authorization and to the prevailing party. Ohio Rev. Code Ann. § 2721.16; *Sturt v. Grange Mut. Cas. Co.*, 761 N.E.2d 1108, 1113 (Ohio Ct. App. 2001).

C. Summary Judgment on Duty to Indemnify

Because the St. Paul policies do not arguably cover the patent infringement claims, they cannot be held to require indemnification on those claims. We therefore affirm the district court's determination that St. Paul had no duty to indemnify Mor-Flo.

CONCLUSION

For the foregoing reasons, we **AFFIRM** the judgment of the district court vacating the default judgment against St. Paul; we **AFFIRM** the portion of the judgment holding that the St. Paul insurance policies did not cover claims for patent infringement, and we **REVERSE** the portion of the judgment holding that St. Paul had a duty to defend Mor-Flo in the patent infringement litigation and awarding costs and attorney's fees.

APPENDIX B — MEMORANDUM OF OPINION AND ORDER GRANTING IN PART AND DENYING IN PART, PARTIES' CROSS-MOTIONS FOR SUMMARY JUDGMENT AND ENTRY OF JUDGMENT DATED AND FILED JANUARY 28, 2000

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

JUDGE LESLEY WELLS

CASE NO. 1:92CV1747

WALTER L. ABT,

Plaintiff,

-vs-

ST. PAUL FIRE & MARINE INSURANCE CO.,

Defendant.

MEMORANDUM OF OPINION AND ORDER GRANTING IN PART AND DENYING IN PART, PARTIES' CROSS-MOTIONS FOR SUMMARY JUDGMENT

This declaratory judgment action is before the Court on a report and recommended decision ("R&R") filed by United Magistrate Judge David S. Perelman regarding cross-motions for summary judgment. Mr. Abt moved for summary judgment on the grounds St. Paul Fire & Marine Ins. Co. ("St. Paul") breached its duty to provide defense and indemnification and

acted in bad faith. St. Paul cross-moved for summary judgment on parallel grounds contending it did not owe a duty of defense and indemnification and did not act in bad faith.

Each party objected to portions of the R&R, and each responded to the opposing parties' objections. This court must "make a de novo determination of those portions of the R&R to which objection is made." 28 U.S.C. § 636(b)(1). The objections are treated in relation to issues delineated in the R&R in which Magistrate Judge Perelman concluded St. Paul had a duty to defend Mor-Flo Industries, Inc. ("Mor-Flo") under certain insurance policies, but that it had no duty to provide indemnification. He further concluded St. Paul did not act in bad faith and that Mr. Abt is entitled to the attorneys fees, expenses and costs he incurred in bringing this declaratory judgment case. On the issue of pre-judgment interest, Magistrate Judge Perelman suggested the parties submit further briefs. The parties provided such briefs in response to the R&R and this court has considered them.

I. FACTS

Mor-Flo was a manufacturer of water heaters and related products sold in the residential, commercial and manufactured housing markets. (Pl. Mot. S.J. (hereinafter "Doc. No. 94") at 2). The plaintiff, Walter L. Abt, was the president and chief executive officer of Mor-Flo until 1992.[1] (Doc. No. 94 at 2).

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1. St. Paul's papers state Mor-Flo merged with SABH Inc. in 1992. During merger negotiations, SABH declined to assign any value to Mor-Flo's claims against St. Paul. SABH agreed Mor-Flo could

(Cont'd)

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Mor-Flo purchased three insurance policies from St. Paul. The policies were for Comprehensive General Liability ("CGL"), Umbrella Excess Liability ("Excess") and Director's and Officer's Liability ("D&O"). All three policies were in effect from 1 January 1984 to 1 January 1985.[2] The coverage issue in this case involves the language of the CGL and Excess policies. (Doc. No. 94 at 2-3).

The CGL policy states in relevant part:

> General Coverage:
> *Defending lawsuits. We'll defend any suit brought against you or any other protected person for covered claims, even if the suit is groundless or fraudulent. We have the right to investigate, negotiate and settle any suit or claim if we believe that is proper. We'll pay all costs of defending the suit, including interest on that part of any judgment that doesn't exceed the limit of coverage that applies. But we won't defend a suit or pay a claim after the limit of coverage has been used up in paying judgments or settlements.*

(Cont'd)
assign its rights against St. Paul to Mr. Abt without causing any loss of consideration to Mor-Flo's shareholders. Mor-Flo's board of directors approved the assignment to Mr. Abt on 18 March 1992. Mr. Abt paid $1,000 in consideration of the assignment. (Def. Mot. S.J. (hereinafter "Doc. No. 97") at 9).

2. Mor-Flo was an Ohio corporation with its headquarters in Cleveland. The three policies were issued to Mor-Flo through St. Paul's regional service office in Cleveland. Thus, the policies were issued in Ohio to an Ohio insured. (Doc. No. 97, p.7).

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Endorsement to Policy for Advertising Injury:
We'll pay amounts you and other protected persons are legally required to pay as damages for covered personal injury or advertising injury claims resulting from your business activities

Definition of Advertising Injury:
Advertising Injury means any of the following types of interference with someone's rights resulting from any advertisement, advertising or publicity article, broadcast or telecast:

* *Libel, slander or defamation;*
* *Violation of the right of privacy;*
* *Piracy;*
* *Unfair competition;*
* *Infringement of copyright, title or slogan.*

Exclusions:
Advertising Claims. We won't cover advertising injury claims brought against any protected person who is in the business of advertising, broadcasting, publishing or public relations. Nor will we cover advertising injury claims that result from . . . infringement of trademark, service mark or trade name by using any of them on or with the goods, products or services you sell, advertise, or offer for sale. (But this exclusion will not apply to infringement of titles or slogans.)

(Doc. No. 94, Ex. D).

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The language of the Excess policy tracks the CGL policy language. The Excess policy states in relevant part:

> *General Coverage*:
> *The company will indemnify the Insured for all sums which the Insured shall become legally obligated to pay as damages, all as more fully defined by the term "ultimate net loss" on account of.*
>
> 1. *Personal injuries*
> 2. *Property Damages*
> 3. *Advertising Offense to which this Policy applies, caused by an occurrence.*
>
> *Exclusions*:
> *This policy shall not apply: . . . (e) under coverage 3, to claims made against the Insured for: . . . . (2) infringement of registered trade mark, service mark or trade name by use thereof as the registered trade mark, service mark or trade name of goods or services sold, offered for sale or advertised, but this shall not relate to titles or slogans;*
>
> *Definition of Advertising Offense*:
> *The term "Advertising Offense" wherever used herein shall mean:*
>
> 1. *libel, slander or defamation;*
> 2. *any infringement of copyright or of title or of slogan;*
> 3. *piracy or unfair competition or idea misappropriation under an implied contract;*

> *4. any invasion of right of privacy committed or alleged to have been committed in any advertisement, publicity article, broadcast or telecast and arising out of the Named Insured's advertising activities.*

(Doc. No. 94, Ex. E).

One of Mor-Flo's principal competitors was State Industries, Inc. ("State"). On 10 December 1979, State applied for Patent No 4,447,377 covering a method of producing water heaters insulated with foam whereby liquid foam was injected into a plastic envelope surrounding the water tank located inside the outer sheet metal jacket. (Doc. No. 97 at 4). Mor-Flo subsequently developed a plastic sleeve insulated by liquid foam which could be pulled over the top of a water tank. Mor-Flo began to manufacture gas water heaters employing the sleeve process by late 1981. (Doc. No. 97 at 5). As a consequence of Mor-Flo's manufacture and sale of such product, State filed a patent infringement case on 18 July 1984 in the United States District Court for the Eastern District of Tennessee. The complaint alleged several causes of action for patent infringement. (Doc. No. 94, Ex. G). The patent infringement case was consolidated with another case brought against Mor-Flo's subsidiary, American Appliance Manufacturing Corp.[3]

In the meantime, upon being sued in 1984, Mor-Flo's insurance agent contacted St. Paul, gave notice of the pending

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3. The patent infringement suit was captioned *State Indus., Inc. v. Mor-Flo Indus. Inc.*, Case No. 2-84-276, consolidated with Case No. 2-85-26.

litigation and requested defense and indemnification in the action. St. Paul assigned Peter Walchanowicz as claims adjuster on the file. (Doc. No. 94 at 4).

Although there were three active insurance policies issued to Mor-Flo, Mr. Walchanowicz only reviewed the request for coverage under the D&O policy, not under the CGL or Excess policies. Based on his limited review, Mr. Walchanowicz denied coverage of the action in a letter dated 23 May 1985. Based on the denial, Mor-Flo retained its own counsel to represent it in the patent infringement action. (Doc. No. 94 at 4-5).

Following a bench trial on the issue of liability, on 29 May 1986, the Tennessee District Court held that Mor-Flo had infringed State's patent. *State Indus., Inc. v. Mor-Flo Indus., Inc.*, 948 F.2d 1573, 1575-76 (1991). On appeal, the U.S. Court of Appeals for the Federal Circuit affirmed the Tennessee District Court. Subsequently, the District Court held a bench trial on the issue of damages. On 21 July 1998, the District Court awarded State damages in the approximate amount of $8.7 million. However, because the Court found Mor-Flo's infringement was not willful, it denied enhanced damages and attorney fees. Again, Mor-Flo appealed the District Court's decision. *Id.* The U.S. Court of Appeals for the Federal Circuit affirmed the Tennessee District Court's findings in part, but noted that its findings on the issue of willfulness seemed inconsistent. As a result, the Circuit Court vacated the District Court judgment insofar as it denied enhanced damages and remanded the case to the District Court for an evidentiary hearing to reconsider whether a finding of willful infringement and enhanced damages was

justified. *Id.* On 8 July 1990, the U.S. Supreme Court refused Mor-Flo's petition for review. Mor-Flo paid the judgment in the aggregate amount of $9,925,638 which represented damages and post-judgment interest. After Mor-Flo paid the judgment, the Tennessee District Court held a hearing on the remanded issue, concluded Mor-Flo had not acted willfully and denied enhanced damages. On 14 November 1991, the Circuit affirmed the District Court. *Id*; (Doc. No. 94 at 15-16). The undisputed total amount spent by Mor-Flo in defense of the underlying patent action was $2,250,158.24, representing attorney fees, costs and expenses. (Doc. No. 94, Ex. A).

In the meantime, in 1990 St. Paul sent a letter to the Ohio Insurance Department advising that it had recently submitted a Filing Memorandum. The Filing Memorandum changed the language of both St. Paul's CGL and Excess policies to clarify the intellectual property provisions. Specifically the St. Paul Memorandum states:

> *Our reason for creating these endorsements is to clarify coverage principally for claims which allege that our insured infringed on a competitor's patent or competed unfairly by taking or using intellectual property (e.g. copyrights; patents; and trade secrets) belonging to others. We hadn't intended or expected to defend or cover such claims when we introduced our current Commercial General Liability and Umbrella Liability Protection Insuring Agreements.*

The new language redefined an "advertising injury." Notably, both "piracy" and "unfair competition" were removed from the definition. (Doc. No. 94, Exs. N, O, P).

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In early 1991, Mr. Abt read an article in the *Wall Street Journal* entitled "Insurance Companies Paying Legal Fees On Patent Disputes." The article addressed the availability of insurance coverage for patent infringement actions under the advertising injury clause of CGL policies and suggested insurance companies had a duty both to defend and to indemnify. Mr. Abt gave the article to Mor-Flo's insurance agent who faxed the article to Joanne Noonan, Senior Account Underwriter at St. Paul. (Doc. No. 97. at 8).

Ms. Noonan responded by writing a letter to Mor-Flo in which she acknowledged some insurance carriers were providing coverage for patent infringement claims, but stated there were too many variables involved to explain why St. Paul had denied coverage to Mor-Flo. (Doc. No. 94 at 7-8). Later under oath, Ms. Noonan admitted she wrote the letter without bothering to investigate if other insurance companies had provided such coverage or why Mor-Flo had been denied coverage. (Doc. No. 94, Ex. R at 82-85).

On 16 April 1991, Mor-Flo submitted a request for St. Paul to re-examine whether the advertising injury clause required St. Paul to cover the patent infringement action. (Doc. No. 97 at 8-9). St. Paul opened a file and assigned it to claims representative Jacqueline McCroskey. Neither Ms. McCroskey nor anyone in St. Paul's Cleveland office had handled a coverage question under the advertising injury clause of the CGL or Excess policy. (Doc. No. 94 at 8-9). In the course of her review of the file, Ms. McCroskey discovered the first claims adjuster mistakenly had reviewed only the D&O policy for coverage. Ms. McCroskey sent a memo about the mistake to the Claims Supervisor telling him coverage had never been explored under the CGL or Excess policies. (Doc. No. 94, Ex. Y).

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On 2 May 1991, Ms. McCroskey contacted outside counsel for a coverage opinion. Ms. McCroskey provided outside counsel background information, including the fact that coverage had been denied under the D&O policy, and referred to the *Wall Street Journal* article sent by Mor-Flo. (Doc. No. 94, Ex. T). Outside counsel reviewed the information and requested actual copies of the policies. (Doc. No. 94, Ex. U). Subsequently, outside counsel advised Mor-Flo regarding his initial review by a letter dated 26 June 1991, that stated:

> *What we do have is a split in California between two different United States District Courts. In Minnesota, the District Court and then the Eighth Circuit Court of Appeals found that coverage was provided within the policies. In New York, that state's highest court, the Court of Appeals, declined to broadly read the "advertising injury" clause to include coverage for claims of patent infringement and therefore denied coverage. . . . So far, no official, unofficial or slip opinion reports have been found of any Ohio decision on the above issues. . . .*

(Doc. No. 94, Exs. X, W).

On 11 July 1991, outside counsel sent Ms. McCroskey two articles concerning coverage in the case. Both articles suggested there was coverage for patent infringement actions under the advertising injury clauses of the CGL policy. (Doc. No. 94, Ex. Z). One of the articles specifically

addressed whether "piracy" could include patent infringement actions. The article stated:

> *The district court also found that the "piracy" term in the advertising clause provided a basis for coverage, particularly since it was undefined in the policy and thus had to be construed against the insurer. The court recognized that the term "piracy" has been used consistently by the courts to refer to patent infringement, beginning with the Supreme Court case of Graver Tank & Mfg. Co. v. Linde Products Co., 339 U.S. 605 (9950) ("One who seeks to pirate an invention, like one who seeks to pirate a copyrighted book or play, may be expected to introduce minor variations to conceal and shelter the piracy"). This language has been cited in literally hundreds of cases. . . . Thus, given the inherent ambiguity of the language of the advertising clause, particularly with regard to such terms as "piracy", and the rule that ambiguities in the policy are to be interpreted in favor of the insured, insurance companies find it difficult to deny a defense to their insureds when faced with an intellectual property claim.*

(Doc. No. 94, Ex. Z).

Near the end of July, Ms. McCroskey provided her supervisor with a summary of the Mor-Flo history and recommended a reserve be posted in the amount of $500,000 with an expense reserve of $1,000,000. (Doc. No. 94, Ex. AA).

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On 27 September 1991, outside counsel sent St. Paul his final legal opinion about the coverage issue. Again acknowledging the absence of Ohio law and the Circuit split, he concluded St. Paul did not have a duty to defend or indemnify Mor-Flo. The letter did not address the standard for applying the duty to defend. (Doc. No. 94, Ex. CC).

Based on the legal opinion, Ms. McCroskey sent an internal memorandum to St. Paul's home office and recommended both defense and indemnification be denied for the patent infringement action filed against Mor-Flo. (Doc. No. 94, Ex. DD). St. Paul issued a denial letter to Mor-Flo on 7 November 1991. (Doc. No. 94, Ex. EE).

This declaratory judgment litigation ensued.

II. STANDARD OF LAW

Summary judgment is appropriate if the evidence in the record shows there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c). The Supreme Court has further explained:

> *[T]he plain language of Rule 56(c) mandates the entry of summary judgment, after adequate time for discovery and upon motion, against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case and on which that party will bear the burden of proof at trial. In such a situation, there can be "no genuine issue as to any material fact," since*

> *a complete failure of proof concerning an essential element of the nonmoving party's case necessarily renders all other facts immaterial.*

Celotex Corp. v. Catrett, 477 U.S. 317, 322-23 (1986). Where the nonmoving party has the burden of proof in a case, the initial burden on the moving party under Rule 56 "may be met by pointing out to the court that the respondent, having had sufficient opportunity for discovery, has no evidence to support an essential element of his or her case." *Betkerur v. Aultman Hosp. Ass'n*, 78 F.3d 1079, 1087 (6th Cir. 1996).

"When a motion for summary judgment is made and supported as provided in [Rule 56], an adverse party may not rest upon the mere allegations or denials of the adverse party's pleading, but . . . must set forth specific facts showing that there is a genuine issue for trial." Fed. R. Civ. P. 56(e). The "mere existence of a scintilla of evidence in support of the [nonmovant]'s position will be insufficient; there must be evidence on which the jury could reasonably find for the [nonmovant]." *Anderson v. Liberty Lobby. Inc.*, 477 U.S. 242, 252 (1986). In considering a motion for summary judgment, the evidence must be viewed in the light most favorable to the party opposing the motion, *Matsushita Elec. Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986). However, "conclusory allegations standing alone will not defeat a properly supported motion for summary judgment." *White v. York Int'l Corp.*, 45 F.3d 357, 363 (10th Cir. 1995).

In the instant case, both parties have acknowledged Ohio law is controlling. (Doc. No. 94 at 24; Doc. No. 97 at 15)

Appendix B

III. LAW & ANALYSIS

A. *Whether St. Paul owed Mor-Flo a duty to defend*

In his R&R, Magistrate Judge Perelman correctly found St. Paul had a duty to defend Mor-FIo.[4]

The duty to defend must be examined in light of the facts and law existing at the onset of the underlying litigation and not at its resolution or the resolution of a subsequent declaratory judgment action. *See Socony-Vacuum Oil Co. v. Continental Casualty Co.*, 59 N.E.2d 199, 203 (1945); *see also Panzica Constr. Co. v. Ohio Cas. Ins. Co.*, No. 69444 LEXIS 1975 at * 21 (1996 Ohio App. May 16, 1996). Moreover, the duty to defend will continue to exist until it is determined there is no possibility of coverage under the policy based on the allegations in the complaint. *See Insurance Co. of N. Am. v. Travelers Ins. Co.*, 692 N.E.2d 1028, 1035 (1997).

St. Paul argues there was no possibility of coverage under the policy. It grounds this argument on the lack of explicit language covering patent infringement actions and on the fact that, in 1991, the Ohio courts had not yet decided the issue of whether patent infringement actions were covered under the advertising injury clause.

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4. St. Paul argues it is unfair to find it had no duty to indemnify in the underlying action and yet require payment for defense of the same action. This argument fails to take into account the different breadth of the two duties. *See Reliable Springs Co. v. St. Paul Fire & Marine Ins. Co.*, 869 F.2d 993, 994 (6th Cir. 1989).

However, the Supreme Court of Ohio has considered and rejected this argument. In *Willoughby Hills v. Cincinnati Ins. Co.*, 9 Ohio St.3d 177 (1984), two defendants sued a municipality for constitutional violations and defamation. Although the municipality's insurance policy with Cincinnati Insurance did not explicitly provide coverage for these types of suits, both were arguably covered within the policy. The municipality notified its insurance company of the claims and requested defense and indemnification. Claiming there was no coverage under the policy for the actions, Cincinnati Insurance refused to provide a defense or indemnification.

The municipality brought a declaratory action against Cincinnati Insurance claiming the insurer owed a duty of defense and indemnification in both actions. The trial court agreed with the insurer and granted summary judgment. The Court of Appeals affirmed the lower court and certified the following question for review: "Is the duty of an insurer to defend its insured determined solely by the allegations of the pleadings when read in light of the coverage provided by a liability insurance policy, as decided by this court in the within action?" The Supreme Court of Ohio reversed the lower courts and found the insurer owed a duty of defense. The Court based its holding on Ohio's adoption of notice pleading which does not require specific factual allegations to be set forth in a complaint. Specifically, the Court stated:

> *It follows that the pleadings alone may not provide sufficient factual information to determine whether the insurer has an obligation to defend the insured.*

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* * *

> *However, where the insurer's duty to defend is not apparent from the pleadings in the case against the insured, but the allegations do state a claim which is potentially or arguably within the policy coverage, or there is some doubt as to whether a theory of recovery within the policy coverage had been pleaded, the insurer must accept the defense of the claim.*

Willoughby, 9 Ohio St.3d at 179-80. Thus, if an insured can show possible or arguable ground for coverage, the insurer will owe a duty to defend.[5]

In the instant case, the duty to defend initially arose when the complaint was filed against Mor-Flo in 1984. Although the policies did not explicitly cover patent infringement, these types of actions were arguably covered under the advertising injury clause by the terms "piracy" and "unfair competition." At that time, Ohio courts had not ruled whether patent infringement actions were covered by the advertising injury clause and various Circuits had split on the same issue. Consequently, there was no way then to anticipate the legal interpretation of the Ohio courts on this issue. Moreover, the uncertainty of how Ohio courts would decide this issue continued through 1991 when the underlying patent action concluded. Because the Ohio courts had not decided the issue,

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5. St. Paul argues the determination of whether there is potential coverage hinges on a purely fact-based analysis and not on a legal uncertainty. However, the Willoughby court makes no such distinction.

coverage was arguably present for patent infringement actions throughout the litigation of the underlying claim. Consequently, this Court reaches the same conclusion as did Magistrate Judge Perelman. St. Paul owed a duty of defense to Mor-Flo.

B. Whether St. Paul owed Mor-Flo a duty to indemnify

In his R&R, Magistrate Judge Perelman correctly finds St. Paul did not have a duty to indemnify Mor-Flo.

To determine whether a patent infringement action is covered, this Court first must look to the language of the insurance contract. Construction of an insurance contract is a matter of law for the court. *See United National Ins. Co. v. SST Fitness Corp.*, 182 F.3d 447, 449 (6th Cir. 1999). Ohio courts have uniformly held when the language of an insurance contract is ambiguous, it must be interpreted in favor of the insured and strictly against the insurer. *See, eg., Blohm v. Cincinnati Ins. Co.*, 39 Ohio St.3d 63, 65 (1988). However, a court cannot interpret what has no need of interpretation. *See Reliable Springs*, 869 F.2d at 995. When the "provisions of an insurance policy are clear and unambiguous courts may not indulge themselves in enlarging the contract by implication in order to embrace an object distinct from that contemplated by the parties." *Gomolka v. State Automobile Mutual Ins. Co.*, 70 Ohio St.2d 166, 168 (1982).

According to the plain language of St. Paul's policy, coverage will only be provided if: 1) there is an advertising injury, and 2) there is a causal connection between the damages and the insured's advertising.

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In the instant case, Mr. Abt contends the CGL and Excess policies arguably provided coverage for the patent infringement action under the advertising injury clause. This clause states, "We'll pay amounts you . . . are legally required to pay as damages for . . . advertising injury claims . . ." The policies define an advertising injury as:

> *any of the following types of interference with someone's rights resulting from any advertisement, advertising or publicity article, broadcast or telecast:*
>
> * *Libel, slander or defamation;*
> * *Violation of the right of privacy;*
> * *Piracy;*
> * *Unfair competition;*
> * *Infringement of copyright, title or slogan.*

Mr. Abt contends that while patent infringement is not listed as an advertising injury, the policies identify both "piracy" and "unfair competition" as covered advertising injuries. He contends further that the language is unclear as to whether St. Paul meant to construe these terms narrowly since the policy defines neither "piracy" nor "unfair competition." The plain meaning of at least "piracy" seems to include patent infringement actions. The 1991 abridged edition of Black's Law Dictionary defines "piracy" as, "illegal reprinting or reproduction of copyrighted matter or to unlawful plagiarism from it; and, similarly, to the unlawful reproduction or distribution of property protected by *patent* and trademark laws." Therefore, Mr. Abt concludes the policy is ambiguous and should be interpreted in his favor.

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For guidance in the analysis of St. Paul's policy language, this Court looks to the recent Sixth Circuit case of *Herman Miller Inc. v. Travelers Indemnity Co.*, 162 F.3d 454 (6th Cir. 1998).[6] In *Herman Miller*, the plaintiff was sued for patent infringement by a competitor. As in the instant case, the Plaintiff requested its insurer provide defense and indemnification for the action pursuant to the advertising injury clause of its insurance policy. Under the clause, Travelers agreed to cover any damages "caused by an . . . 'advertising injury.' " The policy defined an advertising injury as:

> *Injury arising out of the named insured's advertising, promotional or publicity activities conducted during the policy period, because of libel, slander, piracy, unfair competition, idea misappropriation, or infringement of copyright, title or slogan.*

Herman Miller, 162 F.3d at 455 (emphasis added). Travelers refused to provide defense or indemnification in the action. The Plaintiff initiated a declaratory judgment action which was removed to the United States District Court for the Western District of Michigan. Travelers filed a motion for summary judgment arguing the advertising injury clause of its policy did not provide coverage for patent infringement actions. The District Court granted the motion and the Plaintiff appealed.

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6. *In Herman Miller* the Sixth Circuit was applying Michigan law. However, Michigan and Ohio law concerning construction of insurance contracts are substantially the same. *Herman Miller*, 162 F.3d at 455 (applying Michigan law); *Reliable Springs*, 869 F.2d at 995 (applying Ohio law).

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On appeal, the Sixth Circuit found the policy language was unambiguous and affirmed the District Court. Specifically the Court found,

> *. . . courts are not to apply "technical or strained constructions" to a policy's terms, but rather to read a policy in its entirety, giving commonly understood meanings to all of its terms. Viewed alone, we could not say that the terms "piracy," "idea misappropriation," or "unfair competition" could never constitute patent infringement. However, to draw such an inference when considering these terms within the policy as a whole construes them too broadly.*
>
> *The policy does include copyright infringement in its definition of "advertising injury." There is not, however, any reference to patent infringement, although such mention could have been just as easily added to the policy had that been the parties' intention. This Court's decision in Advance Watch is sufficiently analogous to this case to guide our reasoning. Interpreting a clause identical to the one before us, we found in Advance Watch that coverage for trademark infringement could not be implicated by the given definition of "advertising injury." "Recognition of trademark and trade dress infringement as a distinct category of actionable conduct is so common that the only reasonable assumption is that if Travelers had intended to provide coverage for such liability, the insurer would have referred to it by name in*

> *the policy, as it did in the case of 'infringement of copyright, title or slogan.' "*

162 F.3d at 455 (internal citations omitted).

The policy language considered by the Sixth Circuit in *Herman Miller* is substantially the same as the policy language in the instant case. As in *Herman Miller*, St. Paul's policies list both "piracy" and "unfair competition" as covered advertising injuries. This court cannot apply technical or strained construction to a policy's terms, but must read them in their entirety, giving commonly understood meanings to all the terms. *Id.* Here, the policies do not include patent infringement in their definition of "advertising injury", although St. Paul could have easily added it to the policy had it been their intention to provide such coverage. To draw an inference of coverage in the absence of explicit language would be construing the policies too broadly under the Sixth Circuit analysis. Thus, this Court agrees with Magistrate Judge Perelman's conclusion. St. Paul did not owe a duty to indemnify Mor-Flo.[7]

---

7. St. Paul's policies only provide coverage if there is an advertising injury and there is causation. Since there is no advertising injury, whether causation is present need not be addressed.

Appendix B

C. Whether St. Paul acted in bad faith

Magistrate Judge Perelman correctly cited the law and found St. Paul did not act in bad faith. To prove the tort of bad faith. A plaintiff must show:

> *An insurer fail[ed] to exercise good faith in the processing of a claim of its insured where its refusal to pay the claim [was] not predicated upon circumstances that furnish[ed] reasonable justification therefor.*

Zoppo v. Homestead Ins. Co., 644 N.E.2d 397 (1995). If the insurer breaches its duty to act in good faith, punitive damages may be awarded to the insured provided there is proof of actual malice, fraud or insult on behalf of the insured. *Id.* at 557-58. Actual malice is defined as:

> *that state of mind under which a person's conduct is characterized by hatred, ill will or a spirit of revenge, or a conscious disregard for the rights and safety of other persons that has a great probability of causing substantial harm.*

Preston v. Murty, 512 N.E.2d 1174, 1176 (1987).

In the instant case, St. Paul did not act in bad faith. The insurer's coverage decision was not the result of a purely inter-company decision. Instead, St. Paul properly hired outside counsel to give an independent legal opinion as to coverage. Although this court finds there was a duty to defend, St. Paul was not required to second guess the legal

opinion of its counsel. St. Paul's legal consultation together with the lack of Ohio precedential law on the critical issue shows the insurer's decision was made with reasonable justification. Consequently, this Court concurs with Magistrate Judge Perelman. St. Paul did not act in bad faith.

IV. DAMAGES

Although St. Paul did not act in bad faith, this Court has found it did owe Mor-Flo a duty of defense. St. Paul's decision not to defend unnecessarily caused its insured, Mor-Flo, to expend money for attorney fees and costs of defense in the underlying patent action and Mr. Abt to expend funds to prosecute this declaratory judgment action.

> *Where an insurance company, under a policy of liability insurance, unjustifiedly refuses to defend an action brought against the insured, and the insured subsequently brings a declaratory judgment action against the insurer to determine its obligation to defend, the insurer is responsible for the attorney fees incurred by the insured, both in the action which the insurer failed to defend and in the declaratory judgment action.*

City of Willoughby Hills v. Cincinnati Ins. Co., 499 N.E.2d 31, 34 (1986) (*Willoughby II*) (citing *Sykes v. Midwestern Indemn. Co.*, 311 N.E.2d 906 (1973)). Therefore, St Paul is liable for reasonable and proper attorney fees and costs which Mor-Flo spent in the defense of the underlying patent infringement action and which Mr. Abt spent in the instant declaratory judgment action.

Moreover, Mr. Abt is entitled to pre-judgment interest on the underlying patent action the insurer failed to defend and on this subsequent declaratory judgment action. *Willoughby II*, 499 N.E.2d 34. Pre-judgment interest allows a court to make a plaintiff whole when there is a delay in payment by giving compensation for the period of time between the accrual of the claim and judgment. *See Myers v. Central Ins. Co.*, 695 N.E.2d 49, 54 (1997); *Royal Electric Constr. Corp. v. Ohio State Univ.*, 652 N.E.2d 687 (1995). Pre-judgment interest can be granted even if the sum due is unliquidated, when the amount is capable of being ascertained by mere calculation. *Willoughby II*, 499 N.E.2d at 34.

In Ohio, pre-judgment interest on attorney fees and costs which are owed because of an insurance contract are calculated according to Ohio Revised Code 1343.03(A). *Willoughby II*, 499 N.E.2d 34. Ohio Revised Code 1343.03(A) states:

> *. . . [W]hen money becomes due and payable upon any . . . instrument of writing . . . the creditor is entitled to interest at the rate of ten per cent per annum . . .*

In the underlying patent infringement action, attorney fees and costs became due and payable when Mor-Flo received bills from its law firm. Here, the record is devoid of any evidence showing the date or dates these bills were received by Mor-Flo. Nevertheless, the total amount is capable of ascertainment since the parties have presented an undisputed amount calculated as of 14 November 1991, the conclusion of the underlying patent action. At that time, the

total amount of attorney fees and costs incurred by Mor-Flo was $2,250,158.24. (Doc. No. 94, Ex. A). Thus, Mr. Abt is entitled to recover the base amount of $2,250,158.24 in addition to pre-judgment interest on that amount calculated at the rate of ten percent simple interest from 15 November 1991.

In the current declaratory action, Mr. Abt is entitled to receive attorney fees and costs plus pre-judgment interest. So that the base amount can be ascertained, Mr. Abt shall submit appropriate affidavits, if any, on or before 24 March 2000. St. Paul may file its response, if any, within ten business days of Mr. Abt's filing.

IT IS SO ORDERED.

s/ Lesley Wells
UNITED STATES DISTRICT JUDGE

Appendix B

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

JUDGE LESLEY WELLS

CASE NO. 1:92CV1747

WALTER L. ABT,

Plaintiff,

-vs-

ST. PAUL FIRE & MARINE INSURANCE CO.,

Defendant.

JUDGMENT ENTRY

This Court, having previously entered its memorandum of opinion and order enters judgment as follows:

On Plaintiff Mr. Walter L. Abt's motion for summary judgment this Court: 1) grants Mr. Abt's motion for summary judgment in that St. Paul Fire & Marine Ins. Co. ("St. Paul") owed a duty of defense; 2) denies Mr. Abt's motion for summary judgment in that St. Paul did not owe a duty of indemnification; and 3) denies Mr. Abt's motion for summary judgment in that St. Paul did not act in bad faith.

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On Defendant St. Paul's cross-motion for summary judgment this Court: 1) denies St. Paul's motion for summary judgment in that it owed a duty of defense; 2) grants St. Paul's motion for summary judgment in that it did not owe a duty of indemnification; and 3) grants St. Paul's motion for summary judgment in that it did not act in bad faith.

Insofar as this Court has granted Mr. Abt's motion for summary judgment he is entitled to receive both damages for the defense of the underlying patent infringement action and damages incurred in bringing the current declaratory judgment action.

With respect to the underlying patent infringement action, Mr. Abt is entitled to receive reasonable and proper attorney fees and costs which were spent in the defense of that action. Final judgment is awarded as to the base amount of $2,250,158.24 plus pre judgment interest on that amount at ten percent simple interest from 15 November 1991.

With respect to the current declaratory judgment action, Mr. Abt is entitled to receive reasonable and proper attorney fees and costs spent in bringing this action. Final judgment is reserved on this amount since the parties have the opportunity to submit appropriate affidavits and papers. Mr. Abt shall file his submissions on or before 24 March 2000. St. Paul may file its response, if any, within ten business days of Mr. Abt's filing.

Each party shall pay its own costs.

IT IS SO ORDERED.

s/ Lesley Wells
UNITED STATES DISTRICT JUDGE

APPENDIX C — REPORT AND RECOMMENDED DECISION OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF OHIO, EASTERN DIVISION DATED AND FILED MAY 27, 1998

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

Case No. 1:92CV 1747

Chief Judge George W. White

Magistrate Judge David S. Perelman

Walter L. Abt,

Plaintiff

v.

St. Paul Fire & Marine Insurance Co.,

Defendants

REPORT AND RECOMMENDED DECISION

This diversity action before the court under cross-motions for summary judgment,[1] arises from a dispute as to the defendants' obligations under insurance policies issued

1. The parties agree that these motions are to be resolved by applying Ohio law.

to Mor-Flo Industries, Inc. (Mor-Flo),[2] said to be a "leading material manufacturer of water heaters and related products" sold in the residential, commercial and manufactured housing markets. The complaint seeks a declaratory judgment specifying defendant's obligations under the applicable insurance policies; compensatory damages for breach of specified terms of the applicable insurance policies; compensatory and punitive damages for breach of an insurer's "covenant of good faith and fair dealing by acting in bad faith and willfully and maliciously failing to perform its duties and obligations under" the applicable policies; and attorneys' fees, costs and interest from the date of judgment in a lawsuit filed in the United States District Court for the Eastern District of Tennessee on July 18, 1984 against Mor-Flo by one of its principal competitors, State Industries, Inc. ("State").[3]

---

2. The Plaintiff, Walter L. Abt, and his father and brother were controlling shareholders of Mor-Flo. The plaintiff was the president and chief executive offcer until July 1992, when Mor-Flo merged with SABH (U.S.), Inc., after which he remained as a consultant to the newly-formed company. During the merger negotiations SABH agreed that Mor-Flo could retain its claim against defendant and assign that claim to Mr. Abt. Such assignment was approved by the MorFlo board of directors, and it is consequent to that assignment that this action was filed in Mr. Abt's name. Nevertheless, as it is the relationship between Mor-Flo and the defendant which is at issue for the purpose of this opinion the term "plaintiff" shall mean Mor-Flo, unless otherwise indicated.

3. That case was captioned *State Industries. Inc. v. Mor-Flo Industries, Inc.*, Case No. 2-84-276. State filed a nearly identical complaint against a wholly owned subsidiary of Mor-Flo, *State Industries, Inc. v. American Appliance Manufacturing Corp.*,

(Cont'd)

Appendix C

The following insurance policies issued by St. Paul to Mor-Flo for the period January 1, 1984 through January 1, 1985 define the disputed coverage: Comprehensive General Liability Policy, No. 534JK0405 ("CGL Policy"); Umbrella Excess Liability Policy, No. 534XD0140 ("Excess Policy"); and Director's and Officer's Liability Policy, No. 566KF0263 ("D & O Policy").

The CGL Policy language pertaining to St. Paul's duty to defend is:

> *Defending lawsuits.* We'll defend any suit brought against you or any other protected person for covered claims, even if the suit is groundless or fraudulent. We have the right to investigate, negotiate and settle any suit or claim if we believe that is proper. We'll pay all costs of defending the suit, including interest on that part of any judgment that doesn't exceed the limit of coverage that applies. But we won't defend a suit or pay a claim after the limit of coverage has been used up in paying judgments or settlements.

(Cont'd)

Case No. 2-85-26, in the same court, which was subsequently consolidated with the aforementioned case. For ease of reference, those cases will be alluded to as the "underlying suit" or "underlying action."

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A broadening endorsement to the CGL Policy addresses coverage for "advertising injury":

Personal Injury and Advertising Injury Coverage

We'll pay amounts you and other protected persons are legally required to pay as damages for covered personal injury or advertising injury claims resulting from your business activities.

* * * * *

Advertising Injury means any of the following types of interference with someone's rights resulting from any advertisement, advertising or publicity article, broadcast or telecast.

* Libel, slander or defamation.
* Violation of the right of privacy.
* Piracy.
* Unfair competition.
* Infringement of copyright, title or slogan.

* * * * *

Exclusions - Personal Injury or Advertising Claims We Won't Cover

* * * * *

Advertising claims. We won't cover advertising injury claims brought against any protected person

who is in the business of advertising, broadcasting, publishing or public relations. Nor will we cover advertising injury claims that result from:

* * * * *

> *infringement of trademark, service mark or trade name by using any of them on or with the goods, products or services you sell, advertise, or offer for sale (But this exclusion will not apply to infringement of titles or slogans.);

* * * * *

The Excess Policy provides in pertinent part as follows:

I. COVERAGE

The Company will indemnify the Insured for all sums which the Insured shall become legally obligated to pay as damages, all as more fully defined by the term "ultimate net loss" on account of:

1. Personal Injuries,
2. Property Damage,
3. Advertising Offense, to which this Policy applies, caused by an occurrence.

* * * * *

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EXCLUSIONS:

This Policy shall not apply:

* * * * *

(e) under coverage 3, to claim made against the Insured for:

(2) infringement of registered trade mark, service mark or trade name by use thereof as the registered trade mark, service mark or trade name of goods or services sold, offered for sale or advertised, but this shall not relate to titles or slogans;

DEFINITIONS

1. ADVERTISING OFFENSE

The term "Advertising Offense" wherever used herein shall mean:

(1) libel, slander or defamation;
(2) any infringement of copyright or of title or of slogan;
(3) piracy or unfair competition or idea misappropriation under an implied contract;
(4) any invasion of right of privacy; committed or alleged to have been

> committed in any advertisement, publicity article, broadcast or telecast and arising out of the Named Insured's advertising activities.

On December 10, 1979, State applied for Patent No. 4,447,377 covering a method of producing water heaters insulated with foam whereby liquid foam was injected into a plastic envelope surrounding the water tank located inside the outer sheet metal jacket. Mor-Flo subsequently developed a modification of State's envelope process by incorporating a plastic sleeve into which the liquid foam was injected and began to manufacture gas water heaters employing the sleeve process by late 1981.

As a consequence of Mor-Flo's manufacture and sale of such product State initiated the underlying suit. The complaint filed in that action alleged in pertinent part:

> 4. Plaintiff, State Industries, Inc., is the owner by assignment of United States Patent No. 4,447,377, per copy attached.
>
> 5. Plaintiff is informed and believes that defendant, since the issuance of Patent No. 4,447,377 and prior to the filing of this Complaint and within the Eastern District of Tennessee, Northeastern Division, has infringed one or more claims of said patent by selling and/or offering for sale water heaters embodying the invention defined in one or more claims of said patent.

6. Plaintiff is informed and believes that defendant, since the issuance of such Patent No. 4,447,377 and prior to the filing of this Complaint, has been and is actively inducing, aiding and abetting others to infringe one or more claims of said Letters Patent in the Eastern District of Tennessee, Northeastern Division, and elsewhere.

7. Plaintiff is informed and believes that defendant, since the issuance of Letters Patent No. 4,447,377 and prior to the filing of this Complaint, has committed acts of contributory infringement of one or more claims of said patent in the Eastern Division of Tennessee, Northeastern Division, and elsewhere.

8. Plaintiff is informed and believes that defendant threatens to continue to infringe one or more claims of Patent No. 4,447,377 and to induce others to infringe one or more claims of said patent, causing plaintiff great and irreparable damage unless enjoined by this Court.

9. Plaintiff is informed and believes that the acts of infringement complained of herein were willfully committed.

Upon being sued Mor-Flo, through its authorized representative, Mr. Charles G. Hamilton of Hamilton Insurance Agency, Inc., contacted St. Paul to inform the

insurer of the pending litigation and to request coverage. St. Paul assigned Mr. Peter Walchanowicz as claims adjuster.

Although he had not been requested to do so by Mor-Flo, Mr. Walchanowicz limited his inquiry to whether St. Paul owed a duty to defend and/or provide coverage to Mor-Flo under the D & O Policy, without considering whether such duty was owed pursuant to the terms of the CGL Policy or the Excess Policy, which were also in effect at that time. As a result of such limited review Mr. Walchanowicz sent Mor-Flo a letter, dated May 23, 1985, denying coverage under the D & O Policy. Based on that denial Mor-Flo retained counsel to represent the company in the underlying suit.

The procedural history of the underlying suit unfolded as follows:

* On May 29, 1986, Mor-Flo was found by the District Court to have infringed State's Patent.

* The decision was affirmed on March 3, 1987, by the United States Court of Appeals for the Federal Circuit.

* On July 21, 1988, the. District Court awarded damages in the approximate amount of $8.7.

* On August 31, 1989, the Court of Appeals affirmed the July 1988 District Court judgment against Mor-Flo and remanded the case to the District Court to consider the issue of willful infringement, with possible increased damages.

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* On July 8, 1990, the United States Supreme Court refused to hear Mor-Flo's petition for review of the Court of Appeal's disposition of the damage case.

* On January 26, 1990, Mor-Flo paid a judgment in the aggregate amount of $9,925,638 in damages and post judgment interest.

* On July 27, 1990, the District Court held an evidentiary hearing directed to the remanded issue of willfulness. On December 13, 1990, the District Court issued its order finding no willful infringement and denied increased damages, and State appealed that decision to the Court of Appeals.

* On November 14, 1991, the Court of Appeals affirmed the December 13, 1990 judgment of the District Court refusing to award increased damages to State, and assessed State for costs in the latest proceedings before the District Court and the Court of Appeals.

The period of infringement was found to have been from May 8, 1984, the date upon which the patent was issued, until June 9, 1986, when Mor-Flo began to manufacture water heaters incorporating a non-infringing method of insulation. The breakdown of the damage award was: $5,336,306 in lost profits; $1,536,956 in reasonable royalties; and $2,011,409 in prejudgment interest. The amount paid by Mor-Flo

included $2,250,158,24 for attorneys' fees, costs and expenses incurred in defending the underlying suit, plus post judgment interest.

As regards the award for reasonable royalties, the trial court, and later the appellate court, accepted State's argument that Mor-Flo was able to sell more non-infringing products as a result of the marketing/advertising of the infringing water heaters, so that an award for reasonable royalties would need to be increased to reflect such enhanced profits. The specific holding of the trial court was:

> 10. The foam insulated gas residential water heaters introduced by Mor-Flo/American complemented and enhanced their overall product line. In the very competitive water heater industry, Mor-Flo/American's foam insulated gas residential water heaters were an important part of a full line of water heater products which allowed Mor-Flo/American to be more competitive in the market. Having a full line of water heater products allowed Mor-Flo/American to "sell up" (the capability of selling more energy efficient - and more expensive - gas water heaters to customers) and thereby maximize profits on water heater sales. Thus, foam insulated gas residential water heaters constituted an important product line for Mor-Flo/American. . . .

* * * * *

23. State has shown that, as of May 1984, State and Mor-Flo/American had enjoyed success and profit by exploitation of the patented method; that, in May of 1984, State and Mor-Flo/American were head-to-head competitors; and that, as of May 1984, gas residential water heaters foamed using the patented method were already a valuable, fully developed and commercially established part of Mor-Flo/American's product line. The hypothetical license would allow Mor-Flo/American to market foam insulated water heaters in direct competition with State. Consequently, State would not have been reasonable in taking a royalty not out of its profit range . . . In addition, Mor-Flo/American reasonably should have been willing to pay a higher royalty because Mor-Flo/American's water heaters foamed using the patented method were a valuable part of an established commercially successful product line.

24. The presence of foam insulated water heaters in its product line, allowed Mor-Flo/American to be more competitive in the market, lead to the opportunity to increase profits, and gave Mor-Flo/American the ability to "sell up." These were important benefits which were promoted by Mor-Flo/American in their trade literature in 1984 and before. Anticipated collateral sales result in

> parties agreeing to higher royalty rates, because more is involved than making the sale of the infringing product. . . .
>
> 28. Among the evidentiary factors set forth in the Georgia-Pacific case . . . that the Court considers relevant to this case are:
>
> * * * * *
>
> (b) the value of having a foam insulated water heater as part of a "full line" of water heater products;
>
> * * * * *

The appellate court similarly stated:

> The value of collateral sales could also be factored into the royalty rate. . . . Foam insulation was used to promote Mor-Flo's entire line of heaters. And it was not inappropriate for the district court to consider gross profits.

(Citations omitted.)

In letters dated August 29 and September 7, 1990 written by Ms. Lori O'Keefe, Filings Analyst in the Government Affairs Department of St. Paul, to the Honorable George Fabe, Director of Insurance of the Ohio Insurance Department, and to Mr. Trent Emig of the Ohio Insurance Department, St. Paul advised of its submission of a Filing Memorandum which set out two additional exclusion endorsements to be adopted in order to "clarify the intent of

the intellectual property provisions in both the primary general liability and the umbrella excess coverage forms." Specifically the memorandum states:

FILING MEMORANDUM

Intellectual Property Exclusion Endorsements

This filing consists of Intellectual Property Exclusion Endorsement, Form No. 47105 Ed. 7-90. These endorsements have been developed for use with both the primary general liability and the umbrella excess coverage forms, respectively. The purpose of each is to:

- add an intellectual property exclusion
- clarify the meaning of advertising injury
- add a definition for the word advertising

Our reason for creating these endorsements is to clarify coverage principally for claims which allege that our insured infringed on a competitor's patent or competed unfairly by taking or using intellectual property (e.g. copyrights; patents; and trade secrets) belonging to others. We hadn't intended or expected to defend or cover such claims when we introduced our current Commercial General Liability and Umbrella Liability Protection Insuring Agreements. We considered the activities which can and do result in those claims to be:

- business risks that should be borne by the insured; and
- uninsurable by us

We've had to defend the aforementioned claims primarily because "infringement of copyright" is one of the covered offenses in our meaning of advertising injury. Our original interpretation was, and continues to be, that the offense involves the infringement of *advertising* copyright — not the infringement of product patents or the infringement or violation of intellectual property rights. **As we've generally been unable to enforce our interpretation of the way the Insuring Agreements read now, we have developed the Intellectual Property Exclusion Endorsements.**

These forms will be used for risks that primarily:

- manufacture or develop computer hardware or software products or systems;
- create or develop computer programs or software;
- have had intellectual property claims;
- have new employees, or have hired employees within last two years who were formerly employed by

competitors and had access to intellectual property which may be used by the insured; or

- don't conduct patent searches on the products or services they create or develop.

As coverage originally contemplated by use of these endorsements has not changed, there is no change or effect on current rate level.

(Emphasis added.)

The Intellectual Property Exclusion Endorsement described in the Filing Memorandum added an express exclusion from coverage for patent infringement actions in the following terms:

1. The following is added to the Exclusions — What This Agreement Won't Cover section. This change excludes coverage.

   Intellectual Property. We won't cover injury or damage that results from the actual or alleged infringement or violation of any of the following rights or laws:

   * copyright;
   * patent;
   * trade dress;
   * trade name;

* trade secrets;
* trademarks;
* other intellectual property rights or laws.

* * * * *

2. The following replaces the meaning of advertising injury in the What This Agreement Covers section. This change limits coverage.

Advertising injury means injury caused by any of the following offenses that result from the advertising of your products or work:

* libel or slander;

* making written or spoken material that belittles the products or work of others known to any person or organization;

* making written or spoken material that violates an individual's right of privacy known to any person or organization; or

* unauthorized taking or use of any advertising material, title or slogan.

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3. The following is added to the What This Agreement Covers section. This change limits coverage.

Advertising means attracting the attention of others for the purpose of seeking customers or increasing sales or business.

In a continuing effort to have St. Paul revisit its denial of coverage, Mr. Tom Hamilton of Hamilton Insurance Agency, Inc. faxed a letter dated February 8, 1991, to Ms. Joanne Noonan, Senior Account Underwriter of St. Paul, in which he requested "St. Paul's response to the enclosed Wall Street Journal article, 2/4/91, on 'Insurance Companies paying legal fees on patent disputes.' " Upon deposition Mr. Abt testified that the article addressed the question of insurance coverage for patent infringement lawsuits under an advertising injury endorsement to comprehensive general liability policies.

Ms. Noonan responded to Mr. Hamilton in a letter dated February 11, 1991 in which she acknowledged that some insurance carriers were providing coverage for patent infringement claims, but stated that there were too many variables involved for her to explain why St. Paul had denied coverage to Mor-Flo. She suggested that Mr. Hamilton submit a claim to the appropriate department for evaluation. In response to deposition questioning on this issue Ms. Noonan admitted that when she wrote that letter she had not attempted to determine why other insurers were providing such coverage, nor had she investigated whether St. Paul had provided any coverage in other patent infringement cases.

Appendix C

On April 16, 1991 Mr. Hamilton submitted documents to the St. Paul service center and requested that the insurer re-examine the possibility of coverage for the underlying action under the advertising injury provisions in the policies issued to Mor-Flo. Shortly thereafter, St. Paul opened a file to do so, and Mr. Fred Turner, Claims Supervisor for St. Paul's Cleveland Service Center, assigned the file to Ms. Jacqueline McCroskey, a claims representative with expertise in medical malpractice and bond claims, who had also handled product liability and auto claims. Prior to receiving this file Ms. McCroskey had never handled a claim invoking advertising injury coverage, had never read the coverage provisions pertaining thereto, and was unaware of anyone in her office who had been assigned such a coverage question.

In a letter dated May 2, 1991,[4] from Ms. McCroskey to Attorney John Baker of the law firm Weston, Hurd, Fallon, Paisley & Howley, Ms. McCroskey confirmed that Mr. Frank Rahilly, Claims Manager for St. Paul's Cleveland Service Center, had initially contacted Mr. Baker to retain him regarding the Mor-Flo claim. In that letter she also provided background information, including the fact that coverage had been denied under the D & O Policy, and referred to Ms. Noonan's interpretation of the Wall Street Journal article which had been directed to defendant by Mr. Hamilton. On May 8th Mr. Baker requested copies of the applicable policies in order to complete "specifically targeted research."

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4. While the first page of the letter bears the date "1990" that appears to have been a typographical error both by reason of the context of the letter and the date on the second page being "1991."

Appendix C

In an internal memo dated May 8th to the "Diary History and Scratchpad" for defendant's Mor-Flo Industries file Mr. Turner noted that Ms. McCroskey had been "directed not to contact the [insured] at all" and that:

> This case involves a patent infringement suit which the [insured] lost. Coverage was disclaimed years ago. As Jackie [McCroskey] points out in her 10 day report, the [insured] saw an article in the Wall Street Journal which prompted them to raise the issue with us again. Coverage being reviewed by John Baker @ WHFPH. Unless he comes up with something convincing to the contrary, it will remain our position that there is no coverage for this claim. Actually, what the [insured] is looking for from us is reimbursement of their atty fees, reported to be over $1 million. Await contact from John Baker. Nothing for Jackie to do until then.

Mr. Baker responded in a letter dated June 26, 1991, in which he summarized the "initial review" of the question of coverage of Mor-Flo:

> What we do have is a split in California between two different United States District Courts. In Minnesota, the District Court and then the Eighth Circuit Court of Appeals found that coverage was provided within the policies. In New York, that state's highest court, the Court of Appeals, declined to broadly read the "advertising injury" clause to include coverage for claims of patent

> infringement and therefore denied coverage ....So far, no official, unofficial or slip opinion reports have been found of any Ohio decision on the above issues. . . .

One of Mr. Baker's summer associates prepared a memorandum in which he stated:

> Only a few courts have had an opportunity to address the issue of whether patent infringement claims fall within the coverage provided under the "advertising injury" clause of a comprehensive general liability policy. In Minnesota and in California courts have applied insurance contract interpretation principles requiring broad interpretation of policy provisions. These courts, construing the "advertising injury" provision in favor of the insured, have held that the "advertising injury" clause provides coverage for patent infringement suits. On the other hand, courts in New York and California have read the "advertising injury" provision as requiring the underlying claim to arise out of advertising activity. Imposing this requirement, these courts have held that a patent infringement injury does not arise out of advertising activities, but arises out of the manufacture, importation, or sale of the infringed good. Since the patent infringement injury does not arise out of advertising activities, these courts have held that the insurers are not required to provide coverage for patent infringement suits.

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In an internal memorandum dated July 9, 1991 prepared by Ms. McCroskey and directed to Mr. Rahilly and to Mr. Harry Veldhuis, Liability Claims supervisor in St. Paul's Cleveland Service Center, she noted the narrow scope of the consideration of the original claim by Mr. Walchanowicz under the D & O Policy only and stated:

> It should be noted that in addition to the D & O Coverage provided under policy no. 566KF0263, Mor-Flo also had general liability coverage provided under policy no. 534JK0405 and umbrella excess liability coverage provided under policy no. 534XD0140. The claim, however, was not reported under either of those two policies and the possibility of existing coverage was not explored at the time that the pending litigation was originally reported.

Ms. McCroskey went on to summarize the history of the claims, as well as the research of Mr. Baker reflecting the split in authorities as to whether patent infringement claims fall within the coverage provided under the "advertising injury" clause of a comprehensive general liability policy.

In a letter dated July 11, 1991, Mr. Baker directed Ms. McCroskey's attention to two articles addressing the issue under consideration, the first of those being an American Bar Association, Section of Patent, Trademark and Copyright Law, Committee Report dated August of 1990, 1990 ABA Sec. Patent, Trademark & Copyright Law Rep. 103, which addressed the issue of insurance coverage in "unfair competition/trade identity lawsuits." That article,

in turn, relied heavily upon an article written by William J. Robinson entitled "Insurance Coverage of Intellectual Property Lawsuits," appearing at 17 AIPLA Quarterly Journal 122 (1989). Mr. Robinson addressed the general issue of coverage as follows:

> Comprehensive General Liability ("CGL") insurance, with the appropriate endorsement, may be used to pay the costs of defending almost any type of claim or counterclaim in an intellectual property case, including copyright, trademark and trade name infringement, misappropriation of trade secrets, violation of the antitrust laws, and unfair competition. A patent infringement defense may also be covered, as may be the defense of an action for breach of a license agreement.
>
> * * * * *
>
> Advertising Injury Coverage, as found in a Broad Form Endorsement, is the clause used in intellectual property litigation. It can be used to defend against claims for patent infringement, trademark, trade name, and copyright infringement, trade secret misappropriation and unfair competition. It has also been construed to encompass antitrust actions. In patent cases, the clause is particularly useful where a charge of inducing patent infringement is present. Advertising is actionable inducement to infringe a patent.
>
> * * * * *

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The term "advertising injury" is a misnomer. Historically, the advertising injury coverage was offered to cover defamation in advertising. It has evolved to cover almost any intellectual property claims, with the primary exception of actions for declaratory relief. Declaratory actions are not covered, because they are not proceedings which seek "damages."

* * * * *

Given the breadth of the duty of defense, which is broader than the duty to indemnify, and the fact that a wrongful denial of coverage may constitute bad faith, the insurer will be hard-pressed to deny coverage of intellectual property claims. Any coverage doubts must be resolved in favor of the insured. As a practical matter, the initial coverage decision will be based upon whether any of the words of the advertising injury clause (e.g., unfair competition) are found in the complaint. Many coverage decisions are being made by insurance defense firms who do not really understand intellectual property law and who will usually recommend coverage.

* * * * *

The decision in the CNA [Casualty of California v. Seaboard Surety Co., 176 Cal.App.3d 598, 222 Cal.Rptr. 276 (1986)] case has had a direct impact on the use of advertising injury clauses to defend cases alleging patent infringement. The most recent case is Aetna Casualty & Surety Co. v.

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Watercloud Bed Co., a November 1988 decision from the California Federal District Court. . . . The case was a declaratory relief action brought by the carrier Aetna against its insured Watercloud as a result of Watercloud tendering the defense of a patent infringement case to Aetna. The decision was upon the carrier's motion for a summary judgment of no duty to defend or indemnify under the policy.

The allegations in the complaint in the underlying action were that Watercloud was "infringing, . . . actively inducing others to infringe, and . . . contributing to the infringement of [plaintiff's patent] . . . in violation of 35 U.S.C. 271." The policy at issue was a Comprehensive General Liability Policy with a Broad Form Endorsement with a "Pre-1986 ISO" clause as set forth above. Aetna's argument had two prongs. First, that none of the allegations in the complaint involved advertising injuries, so that the advertising injury coverage was not triggered. Second, even if the advertising clause was triggered, the patent infringement allegations were not "within the class of wrongs listed in the definition of advertising injury."

The district court ruled against Aetna. The court began its analysis with the recognition that the duty to defend is greater than the duty to indemnify and that the duty to defend is so broad that "if a complaint creates potential liability within the

coverage of the contract, the insurer must defend." The court then turned to 35 U.S.C. 271(a) and held that claims thereunder can involve advertising activity for at least two reasons. First, "use" within 271 (a) includes acts of marketing for venue purposes under 28 U.S.C. 1400(b). Second, under CNA, "advertising activities [were] implicated in" the underlying complaint for patent infringement. The complaint alleged that Watercloud "offered to sell" the infringing products. Watercloud's advertising materials offered the infringing products. The district court then ruled that "Although the term 'advertising injuries' is defined, 'advertising activities' is not, and the term, as in CNA, must be construed against the insurer."

* * * * *

The district court also found that the "piracy" term in the advertising clause provided a basis for coverage, particularly since it was undefined in the policy and thus had to be construed against the insurer. The court recognized that the term "piracy" has been used consistently by the courts to refer to patent infringement, beginning with the Supreme Court case of Graver Tank & Mfg. Co. v. Linde Products Co. [339 U.S. 605 (1950)]. ("one who seeks to pirate an invention, like one who seeks to pirate a copyrighted book or play, may be expected to introduce minor variations to conceal and shelter the piracy"). This language

> has been cited in literally hundreds of cases . . . . Thus, given the inherent ambiguity of the language of the advertising clause, particularly with regard to such terms as "piracy," and the rule that ambiguities in the policy are to be interpreted in favor of the insured, insurance companies find it difficult to deny a defense to their insureds when faced with an intellectual property claim.

(Footnotes omitted.)

During her deposition testimony Ms. McCroskey stated that she would have read the Robinson article upon receiving it in July of 1991. At the end of that month, Ms. McCroskey directed a memorandum to Mr. Veldhuis in which she summarized the history of the Mor-Flo claim and made recommendations as to posting reserves:

> The issue in question is whether or not there may have been a duty to defend and/or coverage for the law suits filed by State Industries against Mor Flo dealing with a patent issue. In particular, coverage is being reviewed under the Advertising Injury portion of our policies. According to the information which we have received to date from our insured's attorney, as well as our review of the complaint, the law suit against Mor Flo was for infringement of a patented process rather than a patented product.

* * * * *

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> At this time it would be my recommendation that we post a reserve of $500,000.00 as well as an expense reserve of $1,000,000.00. **It is more probable that St. Paul may have owed a defense under an explicit reservation of rights. It appears highly questionable whether there would be any coverage for the actual claim. Therefore, the above reserves are being recommended based on what I evaluate to be a much greater exposure on the defense issue. Further, if defense had been assumed under a reservation of rights, it is possible that once the actual basis of the claim was determined, St. Paul may have had the option to withdraw the defense.** In addition to the other information which is attached, copies of both the General Liability Broadening Endorsement and the Umbrella Excess Liability Policy are enclosed with the Advertising Injury portions of the coverage highlighted.

(Emphasis added.) Ms. McCroskey expanded on the foregoing in her deposition testimony:

> A: The purpose of the expense reserve in this case was that the — when the claim was reported to us, it was reported that there had been both — there had already been a judgment.
>
> Q: Correct.

A: So, there was both an indemnity side and an expense side. The insured in this case, Mor-Flo, had expended, I believe, in the area of $2 million to defend the case.

Q: So, the expense reserve is set up to potentially reimburse Mor-Flo for those expenses?

A: It was set up based on the exposure that we saw in that area of the expenses.

Q: Okay, and how do you personally make the determination as to what the indemnity exposure is and, therefore, set up the reserve and what the expense reserve should be, and how do you determine how to set up that reserve?

A: Okay, There's no formula that I use. It's based on the investigation, what we feel our exposure is, and sometimes I'll try to use some sort of a percentile. I mean, do I think we have a ten percent, a 50 percent, and I try to reserve the base off of that, factoring in: what is the worst-case scenario? What is our exposure? And, I'd come up with a reasonable figure.

Q: Okay. Do you remember what the expense reserve was that you set up in this case or that you recommended?

A: A million dollars.

Q: And was it set up at a million dollars?

A: Yes.

Q: And why did you set up, or why did you recommend that it be set up at a million dollars?

A: The reason I recommended that it be set up at a million dollars is that, in this particular case, Mor-Flo had incurred $2 million in expenses, and based on my — based on the investigation that had been done up to July 9th of 1991, I viewed there being a potentially greater exposure on the side of the duty to defend versus there being an indemnity obligation.

* * * * *

A: And in Ohio, from my past experience, you know, the duty to defend is greater than the duty to indemnify, and based on the information that I had on July 9th of 1991, I needed to establish a reserve that could live with this file for the life of the file, and I knew that $2 million had been spent. So, I looked at this and suggested a reserve of $1 million or approximately 50 percent.

Q: Would that be, in your mind, you thinking that there was a 50 percent likelihood that St. Paul would have to pay that money to Mor-Flo?

A: On July 9th of '91, yes, that was probably my reasoning with the information available to me at that time.

Q: Were you troubled by the fact that other courts' decisions ruled that coverage should exist for patent infringement?

A: I don't know if I would say "troubled." There was that realization that there was somewhat of a split, that there was a difference of opinion. That happens.

Upon reviewing the report prepared by Ms. McCroskey, Mr. Veldhuis directed an internal memorandum to Mr. Mike Davies, St. Paul's Senior Claims Manager, in which he expressed his thoughts on the file:

> I'm involved in one other claim involving 'advertising injury; and is [sic] being handled out of S. Carolina . . . We set an indemnity reserve and made a separate expense reserve since we recognized that the cost of defending the case was probably a greater exposure than any award would possibly fall within coverage. We think we have a similar situation here, but in that the expenses have already been incurred and are supposedly 'capped', I'm not sure if you want to handle the

> reserves in that fashion. Let us know in that regard. . . . Given the relative uncertainty of the law in this coverage area and lack of any specific cases in our jurisdiction, we'll be making recommendations based on how we expect the court's [sic] would rule on this issue. . . . I'm confident that the position taken on the D & O policy was correct, but I'm not sure why the general liability policy wasn't reviewed in conjuncture [sic] with the submission of the original complaint. I'm of the impression that we may have an action back against the patent firm that gave the [insured] the advice regarding it's use of state's design, but I don't see the agent as having the duty to determine coverage, i.e., submit the loss under the right policy, given our knowledge of the [insured's] available coverages. Await your thoughts and recommendations regarding future handling and reserve.

The final legal opinion of Mr. Baker on the Mor-Flo claim was sent via letter to Ms. McCroskey dated September 27, 1991. As had already been done, Mr. Baker acknowledged the absence of Ohio case law on the pertinent issues and the split of authorities in other parts of the country, but he did not address Ohio law on an insurer's duty to defend. Ultimately, Mr. Baker opined that St. Paul owed neither a defense nor indemnification under any of the policies with Mor-Flo.

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In an internal office memorandum dated October 2, 1991, Ms. McCroskey summarized Mr. Baker's opinion for Mr. Davies and the Home Office and recommended that a denial letter be issued to Mor-Flo and that the insurer refrain from proceeding with a declaratory judgment action.

During his deposition testimony Mr. Veldhuis described conversations regarding the legal opinion letter and the position to be taken by St. Paul based thereons:

Q: It talks about there being courts in different jurisdictions, some that ruled that advertising injury coverage does cover patent infringement claims and other jurisdictions ruling that advertising injury coverage does not provide coverage for patent infringement claims. Correct?

A: Correct.

Q: Was that what I will call split of authority discussed in connection with deciding whether or not to provide coverage to Mor Flo in this case?

A: Yes, I am sure it did or was.

Q: Do you recall it having been discussed?

A: I recall generally, yes.

Q: Can you tell me what was discussed either in connection with Exhibit 9 or at any time prior to when coverage was denied?

A: I believe in general the concept of the split was discussed. I'm not sure who pointed it out. It may have been myself. At that time, we didn't have a decision from Ohio on the issue of coverage for patent infringement within an advertising injury clause of the policy. So I felt that we were entitled to make our own straight-forward review and interpretation of the policy in respect to this claim.

Q: What do you mean by your own straight-forward review?

A: We were entitled to review the complaint, the policy, and come to a decision with respect to how we felt the coverage would apply or not apply.

Q: I'm just trying to understand. So by that you mean you were not limited by any Ohio law that already existed on the issue. Is that what you're saying?

A: To the best of my knowledge, there was not definitive law on the issue of coverage for patent infringement within an advertising injury clause. So the fact that there was a split

— the courts wasn't controlling in my mind. I had the ability to make a reasonable evaluation of the coverage based on the complaint and the policy and my understanding and interpretation of the policy.

* * * * *

Q: Can you define for me the duty to defend?

A: In general?

Q: Or as it relates to Exhibit 6.

A: With respect to an insurance policy, when there is a covered claim we have a duty to defend that insured if a claim is brought against them.

Q: What if it is unclear as to whether or not the claim is covered under the insurance policy?

A: We need to make a decision as to whether or not, in our opinion, there is coverage under the policy or not.

Q: What if in doing your review it remains unclear as to whether there is coverage or not? Is there a duty to defend or not?

A: Yes. There can be a duty to defend if there is an issue — as to whether or not coverage is unclear.

Q: If there is potentially coverage, is there a duty to defend?

A: Generally, yes.

Q: In denying or your recommendation to deny reimbursing Mor-Flo for any of its expenses in defending itself and attorney's fees and defending itself in the patent litigation, how did you take into account this split of opinion of the jurisdictions outside of Ohio in which some courts found patent infringement to be covered under advertising injury and the opposite?

A: I did not feel that it was unclear despite the fact that there was a split. I felt that it was clear that there was no coverage for this claim under the policy.

(Emphasis added.)

When deposed Mr. Rahilly also provided his insight as to the decision making process as regards denial of the Mor-Flo defense:

A: I do remember discussing this, and I'm sure it was with the parties that were involved in investigating the case. I recall that there was some case law, recent case law, some in California and some in New York I believe, and I think the California — I think we

followed the New York opinion since it's closer to where we operate and California is certainly — well, if they were the only cases available, we would have had to rely on them, but I think they were more certainly weighing towards there had to be coverage in our general area.

* * * * *

Q: Well, as we discussed, the denial letter went out in November of 1991, correct?

A: Uh-huh. I believe so.

Q: Did you have discussions around that time frame with the coverage attorneys for St. Paul and the discussions continued that this remained an unclear area of law; is that correct?

* * * * *

A: Yes. I don't recall. I know through this there was conversation or discussion that it was unclear and they would continue to work on it. I don't recall specifics.

* * * * *

Q: Do you recall anybody from Weston Hurd ever coming back to you and saying that this has become a clear area of law and that there was no coverage?

A: No, I don't.

* * * * *

Q: . . . Other than what you have just told me, do you remember any other discussions with any Weston Hurd attorneys regarding Mor-Flo's claim submitted in 1991 up until the time that the lawsuit was filed in 1992?

A: No, I don't.

Q: Other than Weston Hurd attorneys, were there other attorneys involved in analyzing this coverage issue?

A: Not to my knowledge, no.

Q: So you wouldn't have spoken with any other attorneys, correct?

A: No. correct.

Q: Do you remember why the Weston Hurd counsel or coverage counsel told you that this was an unclear area of law?

A: That there had been decisions in various courts that went one way or the other. I don't recall the specifics. I know they did say in

> their research they had found cases in California, I believe, or that's what sticks in my mind, as having found coverage and/or an obligation to defend. I'm not sure exactly what the merits of the cases were.

St. Paul issued a denial letter to plaintiff dated November 7, 1991 bearing the signature of Ms. McCroskey. That letter tracked the rationale offered in the opinion letter prepared by Mr. Baker.

This litigation ensued.

The disposition of a motion for summary judgment is governed by Rule 56(c) of the Federal Rules of Civil Procedure, which provides for the granting of such motion only where, "[T]he pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." It is the court's function under such a motion to determine whether a genuine issue of material fact exists, as opposed to endeavoring to resolve any such factual issues. *Tee-Pak, Inc. v. St. Regis Paper Co.*, 491 F.2d 1193 (6th Cir. 1974); 6 *Moore's Federal Practice* 56.15 [1.-0].

It is the initial burden of the moving party to demonstrate the absence of a genuine issue of material fact as to an essential element of the claims brought by the non-moving party. *Curto v. Harper Woods*, 954 F.2d 1237, 1241 (6th Cir.

1992); *Wilson v. Zanesville*, 954 F.2d 349, 350-351 (6th Cir. 1992); *Street v. J.C. Bradford & Co.*, 886 F.2d 1472 (6th Cir. 1989).

In *Street v. J.C. Bradford & Co.*, *supra*, the Sixth Circuit Court of Appeals reviewed three then recent decisions of the United States Supreme Court addressing summary judgment practice, *Anderson v. Liberty Lobby Inc.*, 477 U.S. 242 (1986); *Celotex Corp. v. Catrett*, 477 U.S. 317 (1986); and *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986).[5] The court summarized those cases as standing for a number of new principles in summary judgment practice, including the fact that cases involving considerations of state of mind issues (such as discriminatory action) are not automatically inappropriate for summary judgment; that a federal directed verdict standard ("whether the evidence presents a sufficient disagreement to require submission to a jury or whether it is so one-sided that one party must prevail as a matter of law") should be applied to summary judgment motions; that a non-moving party must provide "more than a mere scintilla of evidence" to avoid summary judgment; that the substantive law applicable to the cause of action will govern the materiality of the issues of fact; that the court has no duty to search the record to determine the existence of genuine issues of material fact; and perhaps most significant, that a trial court has more discretion than it would have in the past in weighing the

5. The court's reference to those rulings as representing a "new era" of "dramatic change" may no longer hold true nine years later, but the characterization of their import as to motions for summary judgment being viewed with "more favorable regard" certainly remains true.

evidence offered by the non-moving party, considered in light of the whole record, to determine whether that party's evidence does "more than simply show that there is some metaphysical doubt as to the material facts" or whether it demonstrates that the non-moving party's claims are "implausible". *Id.* at 1479-1480 (Footnotes and citations omitted.)

It is within the discretion of this federal district court to grant a declaratory judgment if a "case represents 'a real controversy between parties having adverse legal interest of such immediacy and reality as to warrant a declaratory judgment.' " *Brown v. Georgeoff*, 562 F. Supp. 1300, 1316 (N.D.Ohio 1983), *citing* C. Wright & A. Miller, *Federal Practice and Procedure*, Federal Courts, §100 (2d ed. 1983). The instant case is one in which declaratory judgment is appropriate.

It is undisputed that in actions based upon diversity of citizenship federal courts are required to apply the laws of the state in which they preside, including that state's choice of law rules. *Erie R. Co. v. Tompkins*, 304 U.S. 64 (1938); *Klaxon Co. v. Stentor Electric Mfg. Co.*, 313 U.S. 487 (1941). Ohio courts apply the "dominant contacts" test to determine which state's substantive law will be applied to resolve an insurance contract dispute. *Gries Sports Enterprises. Inc. v. Modell*, 15 Ohio St.3d 284, 473 N.E.2d 807 (Ohio 1984), *cert. denied*, 473 U.S. 906 (1985); *Borden, Inc. v. Affiliated FM Ins. Co.*, 682 F.Supp. 927 (S.D.Ohio 1987), *affirmed*, 865 F.2d 1267 (6th Cir. 1989), *cert. denied*, 493 U.S. 817 (1989). The parties herein agree that this case is governed by Ohio law.

Appendix C

In support of plaintiffs motion for summary judgment it is asserted that there are no genuine issues of material fact and that plaintiff is entitled to judgment as a matter of law on each of the following propositions: (1) St. Paul breached its duty to defend the underlying action and plaintiff is entitled to recover the costs incurred in that defense; (2) Mor-Flo is entitled to coverage for at least some, if not all, of the damages awarded against it in the underlying suit; (3) plaintiff is entitled to attorneys' fees, expenses and prejudgment interest in this action against St. Paul; and (4) St. Paul acted in bad faith in its denial of a defense and coverage.

In opposing plaintiff's motion defendant contends that the terms of the policies issued to Mor-Flo are not ambiguous, so that they should not be construed against the insurer, and that the patent infringement claims made by State in the underlying action did not come within the terms of any of the policies in general and, in particular, within the definitions of "advertising injury" in the GCL Policy or "advertising offense" in the Excess Policy (both of those terms encompassing "piracy" and "unfair competition"). Defendant buttresses this contention by arguing that there were no findings in the underlying action that advertising by Mor-Flo was the cause of damage to State. Proceeding from such premise defendant asserts that it cannot be held liable for either plaintiff's costs of defense or the damages awarded State in the underlying action.

While maintaining that it had no obligations to plaintiff under its policies, defendant also asserts that if it should be found that it owed any duty there was reasonable justification

for declining to accept the defense of the underlying action, so that it is not subject to liability on a bad faith claim and/ or for punitive damages.

Insurance policies such as those at issue herein impose two separate duties on the part of an insurer, the duty to defend and the duty to indemnify. The duty to defend is a broader-based obligation than the duty to indemnify, as the insured must defend where there is any possibility of coverage. The duty to indemnify only arises where coverage is established. *Reliable Springs Co. v. St. Paul Fire and Marine Ins. Co.*, 869 F.2d 993, 995 (6th Cir. 1989).

An insurer's duty to defend an insured has been defined in *Willoughby Hills v. Cincinnati Insurance Company*, 9 Ohio St.3d 177, 459 N.E.2d 555 (1984). The parties agree that this case is controlling as regards the duty to defend, but have differing opinions as to the case holding and its application to the present case.

In that case the Ohio Supreme Court identified the issue as "whether the determination of the duty to defend is limited solely to an examination of the pleadings in the action against the insured." *Id.* at 179. The insurer argued, as does the defendant in the present case, that there is no duty to defend if the pleadings in the underlying case fail to articulate a claim within the policy coverage, a proposition which the court in *Willoughby Hills* rejected:

> However convenient appellee's suggestion may be, we feel that the duty to defend need not arise solely from the allegations in the complaint but

may arise at a point subsequent to the filing of the complaint.

* * * * *

Like the federal system, Ohio has embraced notice pleading through adoption of the Ohio Rules of Civil Procedure. . . . No longer must a complaint set forth specific factual allegations. . . . In addition, no longer is a trial strictly limited to the issues raised in the pleadings.

It follows that the pleadings alone may not provide sufficient factual information to determine whether the insurer has an obligation to defend the insured. It remains true that whether the pleadings unequivocally bring the action within the coverage afforded by the policy, the duty to defend will attach. . . . However, where the insurer's duty to defend is not apparent from the pleadings in the case against the insured, but the allegations do state a claim which is potentially or arguably within the policy coverage, or there is some doubt as to whether a theory of recovery within the policy coverage had been pleaded, the insurer must accept the defense of the claim. Thus, the "scope of the allegations" may encompass matters well outside the four corners of the pleadings.

In the courts below, the inquiry was erroneously confined strictly to the specific allegations raised

> in the respective complaints. Pursuant to the rule announced herein, we hereby remand the cause to the trial court where it will be determined whether the underlying factual allegations in the . . . complaint arguably or potentially, fall within the coverage afforded by appellee.
>
> As we recognized in *Motorists Mut.*, *supra*, at paragraph one of the syllabus, an insurer may accept the defense and reserve its right to assert "at a later time the policy defenses it believes it has." Nothing prevents the insurer, once the defense is accepted, from utilizing discovery to attempt to clarify the nature of the claim against the insured.

Id. at 179-80 (Citations omitted.) (Emphasis as in original). *Accord*, *Sanderson v. Ohio Edison Co.*, 69 Ohio St. 3d 582, 635 N.E.2d 19 (1994); *Wedge Products. Inc. v. Hartford Equity Sales Co.*, 31 Ohio St. 3d 65, 509 N.E.2d 74 (1987).

The CGL policy in this case specifically stated that the defendant would defend a suit against Mor-Flo even if the suit was groundless, false or fraudulent. That provision parallels one in *Beacon Ins. Co. v. Kleoudis*, 100 Ohio App.3d 79, 82-83, 652 N.E.2d 1 (Cuy.Cnty. 1995), in which it was held that the duty to defend was absolute "where a theory of recovery is even arguably within the terms of the policy[.]"

Therefore, St. Paul had a duty to defend the plaintiff in the underlying case, provided that the allegations that Mor-Flo infringed State's patent by selling and/or offering

for sale water heaters embodying the invention defined in one or more claims of that patent stated a claim which was potentially or arguably within the policy coverage, even if there was some doubt whether a theory of recovery within the policy coverage had been pled.

As reflected in the summary of evidence set forth herein, there are two critical points in time to be considered — May 1985, when the plaintiffs initial request for coverage was rejected, and November 1991, when the plaintiff's renewed request for coverage was rejected.[6]

In this Court's opinion the evidence regarding defendant's investigation directed to the question of whether State's claims of patent infringement were within Mor-Flo's coverage under the advertising injury provision of the GCL policy inevitably leads to the conclusion that the insurer had, or should have had, an awareness that there was a claim, or claims, made against its insured which were potentially or arguably within the policy coverage. This Court considers the following to be particularly indicative of such state of awareness:

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6. The defendant's tacit acknowledgment that this Court's inquiry as to whether there was potentially or arguably coverage for patent infringement under the policies must be undertaken in the context of the time in which the renewed, and not just the initial, decision to deny coverage was made can be found in the following: "There were no decisions in Ohio in 1991 which afforded any guidance as to how Ohio courts would construe these policies under the facts alleged by State industries in Tennessee cases. St Paul could only look to the policy language and the allegations in the Tennessee complaints, the limited case law and the legal opinion of its outside counsel." St. Paul's Motion for Summary Judgment, p. 26.

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(1) the 1990 Filing Memorandum bearing exclusion endorsements adopted to clarify the intellectual property provisions in both policies, with an express exclusion from coverage for patent infringement actions;

(2) the letter accompanying the aforementioned Filing Memorandum in which St. Paul concedes that it has "had to defend [claims of patent infringement] primarily because 'infringement of copyright' is one of the covered offenses in our meaning of advertising injury" and that it had "generally been unable to enforce [their] interpretation the way the Insuring Agreements read now[;]"

(3) the 2/11/91 letter by Ms. Noonan in which she acknowledged that other insurers were providing coverage for patent infringement claims and invited the submission of a claim to the appropriate department for evaluation;

(4) the 6/26/91 letter by Mr. Baker in which he summarized the split in authorities on the issue of whether an advertising injury clause includes coverage for claims of patent infringement, with an appended memorandum detailing the pertinent cases;

(5) the 7/9/91 memorandum by Ms. McCroskey in which she reiterated the information provided by Mr. Baker;

(6) the 7/11/91 letter by Mr. Baker directing Ms. McCroskey's attention to the articles addressing the issue of insurance coverage in intellectual property cases;

(7) the 7/91 memorandum in which Ms. McCroskey summarized the history of the Mor-Flo claim and recommended the posting of reserves based on her belief that there was a 50% chance that St. Paul had a duty to defend Mor-Flo, as was stated in her deposition testimony;

(8) the 7/31/91 internal memorandum of Mr. Veldhuis in which he admitted "the relative uncertainty of the law in this coverage area and lack of any specific cases in our jurisdiction;"

(9) the 9/27/91 final legal opinion of Mr. Baker in which he acknowledged the absence of Ohio case law on the issue of coverage for patent infringement claims and the split of authorities in other parts of the country;

(10) the deposition testimony of Mr. Veldhuis in which he confirmed that the split in authorities on the issue of coverage for

patent infringement claims was discussed among those persons who made the decision to refuse to defend Mor-Flo and in which he recognized an insurer's duty to defend when it is unclear whether a particular claim is covered under a policy; and

(11) the deposition testimony of Mr. Rahilly in which he acknowledged the general awareness that there was a split in authorities on the issue of coverage for patent infringement claims but stated his belief that their denial of coverage was based upon the position taken by a court in New York, reliance upon which occurred as a consequence of the closer proximity of that jurisdiction as compared to others in which courts took an opposite stance on the issue.

While all of this evidence post-dates the initial refusal, this Court believes that had St. Paul performed a proper analysis in 1985, taking into consideration all of the pertinent policies, the only conclusion which could have been reached was that it had the duty to provide a defense to Mor-Flo. That duty should have been even clearer in 1991, when defendant acknowledges that it was aware that there was a split of authorities in the courts outside of Ohio as to the issue of coverage under advertising injury clauses for patent infringement claims, when the defendant refused to accept responsibility for the costs of defense the plaintiff had incurred.

Consequently, it is recommended that Your Honor grant summary judgment in plaintiffs favor on the issue of duty to defend.

Having addressed the defendant's duty to defend, which presents a broader-based obligation on behalf of the insurer, this Court now turns to the defendant's obligation to provide insurance coverage for the damages awarded State in the underlying suit.

The plaintiff maintains that as a matter of law coverage exists for that portion of the damages which represents an award of reasonable royalties on the basis that such award rested upon Mor-Flo's ability to sell more non-infringing products as a result of their marketing-advertising, which plaintiff claims to amount to an advertising injury under the policy provisions called into question herein.

Defendant counters that for each of the following reasons there is no entitlement to coverage for any portion of the damages awarded to State: (1) Mor-Flo's liability in the underlying suit did not arise out of advertising activities; (2) Mor-Flo's infringement was not accidental; (3) patent infringement was not one of the enumerated offenses for which there was coverage in the pertinent policies and such coverage could not be implied; and (4) the infringement deemed actionable in the underlying suit did not constitute "piracy" or "unfair competition."

Under the pertinent provision of the CGL policy, previously set forth herein, an insured is entitled to coverage for damages awarded in cases brought to recover for

advertising injuries, which the broadening endorsement defines as an interference with "rights resulting from any advertisement, [or] advertising or publicity article," including piracy, unfair competition and infringement of copyright, title or slogan. The Excess policy provides indemnification for all sums the insured is legally required to pay as damages on account of "Advertising Offense," which is defined in part as: (1) any infringement of copyright or of title or of slogan; or (2) piracy or unfair competition or idea misappropriation under an implied contract. The plaintiff maintains that patent infringement is encompassed within the terms "piracy" or "unfair competition" and was not among those offenses specifically excluded from advertising injury, so that it is entitled to coverage.

Under the law of Ohio, "[w]hen words used in a policy of insurance have a plain and ordinary meaning, it is neither necessary nor permissible to resort to construction unless the plain meaning would lead to an absurd result." *Blohm v. Cincinnati Insurance Co.*, 39 Ohio St.3d 63, 66, 529 N.E.2d 433, 436 (1988) (Citations omitted.) Accord, *Reliable Springs Co. v. St. Paul Fire and Marine Ins. Co.*, 869 F.2d 993, 995 (6th Cir. 1989). In resolving insurance coverage disputes, policies must be examined in their entirety to determine whether any exceptions to coverage come into play. *Reliable Springs Co.*, *supra* at 994. Where it is clear that a claim is subject to an exclusion there is no duty on behalf of an insurer to defend or indemnify the insured against such claims. *Ibid*; *Zanco Inc. v. Michigan Mutual Ins. Co.*, 11 Ohio St. 3d 114, 464 N.E.2d 513 (1984) (per curiam).

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When there is some ambiguity in policy language it is axiomatic that the ambiguity must be construed in favor of the insured and strictly against the insurer. *Suburban Community Hospital v. Lindquist*, 69 Ohio St. 2d 302, 432 N.E.2d 173 (1982); *Brause v. Royal Maccabees Life Ins. Co.*, 88 Ohio App.3d 149, 153, 623 N.E.2d 638 (Crawford Cnty. 1993); *King v. Nationwide Ins. Co.*, 35 Ohio St. 3d 208, 519 N.E.2d 1380 (1988). As the preparer of the policy the insurer must accept any reasonable interpretation in favor of the insured. *Gomolka v. State Auto. Mut. Ins. Co.*, 70 Ohio St.2d 166, 168, 436 N.E.2d 1347 (1982).

Although the CGL and Excess policies fail to define the terms "piracy." "unfair competition," "business activities," "advertisement," "advertising," and "interference," the meaning of each as understood in the context at issue herein is defined either by case law or common usage, so that they are not ambiguous.

There is, however, a dearth of Ohio precedent addressing the issue of whether an insurance policy's "advertising injury" coverage extends to claims of patent infringement against its insured.

In *Synergystex International, Inc. v. Motorists Mutual Insurance Co.*, 1994 WL 395626 (Ct.App. Medina 1994), the court considered whether a patent infringement suit was an "advertising injury" calling for coverage under general liability policy, an issue that court deemed to have been one of first impression in Ohio. The clause at issue in *Synergstex* defined "advertising injury" as including "misappropriation of advertising ideas or style of doing business" or

"infringement of copyright, title or slogan," but did not include "patent infringement" or "piracy." That court held that in light of the fact that there was no mention in the underlying suit of advertising by or on behalf of the insured there was insufficient causal connection between any advertising and the claimed patent infringement to call for coverage under the "advertising injury" provision. In reaching that conclusion the appellate court stated:

> A patent holder generally is injured by losing sales, profits, or royalties to someone "making, using or selling a patented invention" as set forth in Section 271, Title 35, U.S. Code, and not from advertising a product, **unless that advertising results in sales, profits, or royalties to someone other than the patent holder.**

(Emphasis added.)

Plaintiff argues that the foregoing supports its position, in that in the underlying case the trial and appellate courts held that Mor-Flo was able to "sell up," i.e., to sell more non-infringing products as a result of the marketing/ advertising of the infringing, so that in contrast to the plaintiff in *Synerstex* its advertising did result in sales, profits or royalties to someone other than the patent holder.

While this is not an unreasonable position, this court is not inclined to accept this dicta in the *Synergytex* opinion as representing the proper construction of the "advertising injury" clause at issue in this action. The *Synergytex* court drew upon holdings from other jurisdictions including that

of the Ninth Circuit Court of Appeals in *Iolab Corp. v. Seaboard Surety Co.*, 15 F.3d 1500 (9th Cir. 1994), wherein the court held that "patent infringement cannot constitute an advertising injury because, under 35 U.S.C. § 271, a patent is infringed by making, using or selling a patented invention, not by advertising it." *Id.* at 1506. In *Iolab*, as in the present case, the insured sought indemnification under policies that included "piracy" and "unfair competition" as covered advertising injuries. That court held that unless the patent holder asserted a claim of patent infringement arising out of the infringer's advertising activities in a manner independent of the sale of the patented product the loss to the patent holder would not be covered under the policy. *Ibid.*

As in *Iolab*, in a majority of cases arising under the law of other jurisdictions it has been held that patent infringement (including direct patent infringement, contributory patent infringement, or inducement of patent infringement) does not come within "advertising injury" coverage under policies which include "piracy" and/or "unfair competition" in the definition of advertising injury. *Intex Plastics Sales Co. v. United Nat'l Ins. Co.*, 23 F.3d 254 (9th Cir. 1994); *Heil Co. v. Hartford Accident and Indemnity Co.*, 937 F.Supp. 1355 (E.D.Wis. 1996); *Herman Miller, Inc. v. Travelers Indemnity Co.*, unreported, 1996 U.S.Dist. LEXIS 19899 (W.D.Mi. 1996) (Michigan law); *Classic Corp. v. Charter Oak Fire Ins. Co.*, 35 U.S.P.Q.2d 1726, 1995 WL 295824 (C.D.Cal. 1995); *Gencor Indus. Inc. v. Wausau Underwriters Ins. Co.*, 857 F.Supp. 1560 (M.D.Fla. 1994); *Davila v. v. Arlasky*, 857 F.Supp. 1258 (N.D. Ill. 1994); *I.C.D. Indus., Inc. v. Federal Ins. Co.*, 879 F.Supp. 480 (E.D.Pa. 1995); *Atlantic Mut. Ins. Co. v. Brotech Corp.*, 857 F.Supp. 423 (E.D.Pa. 1994);

Polaris Industries, L.P. v. Continental Ins. Co., 539 N.W.2d 619 (Minn.App. 1995); *Gitano Group Inc. v. The Kemper Group. et al.*, 26 Cal. App. 4th 49, 31 Cal. Rptr.2d 271 (Cal.App. 1994); *Aetna Casualty & Surety Co. v. Superior Court*, 19 Cal.App.4th 320, 23 Cal.Rptr. 2d 442 (Cal.App. 1993); *A. Myers & Sons Corp. v. Zurich American Ins. Group*, 74 N.Y.2d 298, 545 N.E.2d 1206, 546 N.Y.S.2d 818 (1989);

Likewise, other courts have held that patent infringement (including direct patent infringement, contributory patent infringement, or inducement of patent infringement) is not an "advertising activity" which gives rise to coverage under definitions which do not include "piracy" and/or "unjust competition." *Simply Fresh Fruit, Inc. v. Continental Ins. Co.*, 84 F.3d 1105 (9th Cir. 1996); *Everest and Jennings Inc. v. American Motorists Ins. Co.*, 23 F.3d 226 (9th Cir. 1994); *Owens-Brockway Glass Container, Inc. v. International Ins. Co.*, 884 F.Supp. 363 (E.D.Cal. 1995), *affirmed* 94 F.3d 652 (9th Cir. 1996); *St. Paul Fire & Marine v. Advanced Interventional*, 824 F.Supp. 583 (E.D.Va. 1993), *affirmed without opinion*, 21 F.3d 424 (4th Cir. 1994); *Julian v. Liberty Mut. Ins. Co.*, 43 Conn.App. 281, 682 A.2d 611 (Conn.App. 1996).

In each of the foregoing cases the policy language defining "advertising injuries" included language requiring some causal connection between the occurrence giving rise to the underlying suit and the insured's advertising activities, such as "in the course of" or "arising out of" such activities. In the present case the definition found in the CGL policy — any "interference with someone's rights resulting from any advertisement, advertising or publicity article, broadcast or telecast" — also requires causation.

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The causation requirement derives from *Bank of the West v. Superior Court*, 2 Cal.4th 1254, 10 Cal.Rptr.2d 538, 833 P.2d 545 (Cal. 1992), in which the California Supreme Court engaged in a lengthy analysis of causation and explained that it is essential because "[t]aken to its extreme, [the argument that no causal relationship is necessary] would lead to the conclusion that any harmful act, if it were advertised in some way, would fall under the grant of coverage merely because it was advertised. . . . Thus, a great many acts may fall within the ambit of advertising, extending advertising injury coverage far beyond the reasonable expectations of the insured." 10 Cal.Rptr. 2d at 552, 833 P.2d at 559. That court held that a claim brought under the Unfair Business Practices Act alleging excessive finance charges upon automobile insurance premiums failed to occur in the course of the bank's "advertising activities" so that it lacked the required causal connection to bring it within the policy coverage. The court also spoke to the subject of patent infringement:

> [A] claim of patent infringement does not 'occur[ ] in the course of . . . advertising activities' within the meaning of the policy even though the insured advertises the infringing product, if the claim of infringement is based on the sale or importation of the product rather than its advertisement.

Id. at 1275, 10 Cal.Rptr.2d 538, 833 P.2d 545 (citing *National Union Fire Ins. Co. v. Siliconix, Inc.*, 729 F.Supp. 77, 80 (N.D.Cal. 1989)).

The *Bank of the West* case has been accepted by its progeny as requiring proof that the advertising of a patented

product created an injury distinct from that created by the patent infringement in order for there to be coverage under an advertising injury provision. *See e.g, Simply Fresh Fruit Inc. v. Continental Ins. Co., supra* at 1109 ("[U]nder the policy, the advertising activities must cause the injury — not merely expose it."); *Everest and Jennings, Inc. v. American Motorists Ins. Co., supra* at 226 ("Even if true, these facts [increased sales of the infringing product] simply do not establish the necessary causal connection between the alleged infringement and [the insured's] advertising."); *Heil Co. v. Hartford Accident and Indemnity Co., supra* at 1366 ("Thus the gravamen of direct infringement of a patent is making, using or selling a patented invention not advertising it."); *Julian v. Liberty Mut Ins Co., supra* at 617 ("Since the creation of the infringing product must precede its advertisement, the latter can hardly be the cause of the former.").

This Court is of the opinion that within the context of the policies at issue herein, in which there is no mention of patent infringement within the definition of "advertising injury," the terms "piracy" and "unfair competition" refer to "misappropriation or plagiarism found in the elements of the advertisement itself — in its text form, logo, or pictures" — rather than impropriety in the manufacture and sale of the water heaters being advertised. *Iolab Corp. v. Seaboard Surety Co., supra* at 1506.

In this case it cannot be said that the advertising by Mor-Flo of the infringing water heaters created an injury distinct from the infringement found by the state trial court. That being so, this Court concludes that the plaintiff has failed

to meet its burden of demonstrating that the patent infringement at the heart of the underlying suit could have been caused by advertising activity as defined in the policies herein. Absent sufficient causal nexus between the patent infringement alleged and found in the underlying suit and any advertising activity, the plaintiff would not be entitled to coverage under the advertising injury or advertising offense provisions of the St. Paul policies despite the fact that Mar-Flo sold infringing and additional non-infringing water heaters by way of such advertising.

This Court, therefore, recommends that plaintiff's motion for summary judgment on this issue be denied and defendant's motion, as it relates to the same issue, be granted.

In the interest of completeness, this Court will address defendant's argument that the award of reasonable royalties rendered against plaintiff in the underlying suit could not be included in any recovery under the advertising injury and advertising offense provisions of the policies in question.

Defendant contends that reasonable royalties are comparable to restitution and, as such, are not an insurable loss under general liability policies, citing in support of that proposition *Intex Plastic Sales Co. v. United National Ins. Co.*, 1992 WL 437984 (C.D.Cal. June 10, 1992), in which the infringer of a design patent was ordered to pay a reasonable royalty, including prejudgment interest. In a more recent opinion applying California law the court distinguished the *Intex* decision as involving infringement of design patents which may be remedied by recovery of the infringer's profits, a remedy which differs from that available under 35 U.S.C.

§ 284, the applicable statutory authority for determining damages in other patent infringement cases. *Owens-Brockway Glass Container, Inc. v. International Insurance Co.*, 31 U.S.P.Q.2d 1332, 1336, fn.7 (E.D.Cal. 1993). In this case the applicable statutory authority for determining damages in the underlying case was also 35 U.S.C. § 284.

In *Owens-Brockway* there was a jury award against an infringer for approximately $32.5 million, which was to serve as a "running royalty" for the infringement, as well as an injunction preventing further use of the patents. *Id.* at 1333. The parties negotiated a settlement in the amount of $22.5 million to satisfy the judgment for past royalties and coupled that with a non-exclusive license for future use of the patents at issue. *Ibid.* The infringer then sought insurance coverage for the $22.5 payment under the "Advertising Injury" provision in its insurance policies, which the insurer denied. The court denied the insurer's motion for summary judgment, holding:

> Defendants offer a number of different arguments as to why the damages paid by Owens should be viewed as an uninsurable disgorgement of royalties that should have been paid in the normal course of business. First, defendants argue from federal patent law that B & H actually sought and received a royalty remedy. But under the patent laws, a reasonable royalty is simply a method of determining damages and setting a floor for damages. See, Fromson [v. Western Litho. Plate and Supply Co.], 835 F.2d at 1574 (" 'reasonable royalty' is handy shorthand for damages");

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Duplate Corp. v. Triplex Safety Glass, 298 U.S. 448, 451 [29 USPQ 306] (1936) (" '[i]n patent nomenclature what the infringer makes is 'profits,' what the owner of the patent loses by such infringement is 'damages'.' ") (citation omitted). B & H sought damages in its complaint and received them measured by a reasonable royalty. More importantly, even if a separate royalty remedy did exist, the "mere fortuity" of B & H's or the jury's election of remedies — or the presence on the jury's verdict form of the words "running royalty" — cannot determine Owens' insurance coverage under the approach in AIU [Insurance Co. v. FMC Corp., 274 Cal. Rptr. 820 (Cal. 1990)].

See AIU, 274 Cal.Rptr. at 830, 845.

Second, defendants argue that the present case is analogous to those cases which find that restitutionary disgorgement remedies do not give rise to insurable damages. E.g. Jaffe [v. Cranford Ins. Co., 214 Cal. Rptr. 567 (App. 1985)]. But the underlying statutes in those cases strictly defined the insured's payments as restitution or disgorgement in a manner which is not present in the patent statutes at issue here. . . . The statute at issue specifically provided a disgorgement remedy. As with Jaffe, these elements are missing here. [FN 7]

FN 7 Defendants' reliance on Intex Plastics Sales Co. v. United National Insurance Co., No. CV-

> 90-2050 (C.D.Cal., June 10, 1992), is misplaced. Intex is an unpublished opinion of the district court which is not binding on this court. Moreover, at oral argument plaintiff's counsel represented to the court that Intex involved a design patent. Infringement of design patents may be remedied by recovery of the infringer's profits. 35 U.S.C. Section 289. To the extent that Intex found that an infringer's loss under section 289 was uninsurable restitution, it is distinguishable from the present case which does not involve a design patent and for which the section 289 remedy is therefore unavailable.
>
> In sum, the California cases finding uninsurable restitution involve the return by the insured of something which was acquired in violation of a statute. These cases deny coverage for civil restitution awards for Medi-Cal overcharging and disgorgement of money gained through unfair business practices. Owens' payment to B & H for Owens' non-willful infringement of B & H's patents does not fit easily within this category of uninsurable loans.

Id. at 1336-7. (Footnotes omitted.)

In this case, the defendant's opposition to coverage for the award of reasonable royalties parallels that offered by the insurer in the *Owens-Brockway* case and, for the reasons set forth therein, this Court is equally unpersuaded with the arguments so made.

Therefore, this Court is of the opinion that if the plaintiff was entitled to coverage under the pertinent provisions of the St. Paul policies it would be entitled to coverage for the reasonable royalties awarded in the underlying suit.

The next issue to be considered is plaintiff's contention that defendant's refusal to provide a defense or reimburse plaintiff for the cost of defense calls for recovery of the fees, costs and expenses necessitated by the bringing of this action.

Under Ohio law an insured unlawfully denied a defense by its insurer may be granted an award of attorneys' fees and reasonable costs incurred in defending the underlying suit and in bringing a declaratory judgment action to vindicate its rights. *American Employers Ins. Co. v. Metro Regional Transit Authority*, 802 F.Supp. 169, 183-4 (N.D.Ohio 1992), *rev'd on other grounds*, 12 F.3d 591 (6th Cir. 1994), citing *Motorists Mutual Ins. Co. v. Trainor*, 33 Ohio St.2d 41, 47, 294 N.E.2d 874, 878 (1973). An insurer's good faith or bad faith in reaching its decision to refuse to defend is immaterial to such an award. *Allen v. Standard Oil Co.*, 2 Ohio St.3d 122, 126, 443 N.E.2d 497 (1982) (Syllabus). *Accord, American Employers Ins. Co. v. Metro Regional Transit Authority, supra* at 184. The intended end result is to place the insured in "a position as good as that which he would have occupied if the insurer had performed its duty." *Motorists Mut. Ins. Co. v. Brandenburg*, 72 Ohio St. 3d 157, 159, 648 N.E.2d 488 (1995).

Based on this Court's recommendation that summary judgment be granted upon the issue of the duty to defend,

this Court also recommends that there be an award of attorneys' fees and reasonable costs incurred in the present case.[7]

Plaintiff further seeks an award of prejudgment interest "from the date those costs, expenses and attorney fees were incurred," citing to *Willoughby Hills v. Cincinnati Ins. Co.*, *supra*. The defendant has made no argument in response beyond the base assertion that there was no duty to defend. While such failure of response could be considered as a tacit concession that an award of prejudgment interest would be proper, this Court would recommend that the defendant be given the opportunity to address the issue of prejudgment interest in a supplemental submission, with a responsive opportunity afforded to the plaintiff.

Plaintiff also argues that defendant committed the tort of bad faith in rendering its decision as to coverage in the underlying suit, warranting an award of punitive damages.

The parties agree that the elements of the tort of bad faith on behalf of an insurer are delineated in the syllabus of *Zoppo v. Homestead Ins. Co.*, 71 Ohio St.3d 552, 644 N.E.2d 397 (1994), *cert. denied*, 516 U.S. 809 (1995), as follows:

> 1. An insurer fails to exercise good faith in the processing of a claim of its insured where its refusal to pay the claim is not predicated upon circumstances that furnish reasonable justification therefor

7. Supplemental submissions are necessary in order to determine the amount of fees and costs incurred.

(Citations omitted.) If the insurer has been found to have breached its duty of acting in good faith in refusing to pay a claim, punitive damages may be awarded to the insured provided that there has been proof of actual malice, fraud or insult on behalf of the insurer. *Id.* at 557-8, *citing Staff Builders Inc. v. Armstrong*, 37 Ohio St. 3d 298, 525 N.E.2d 783 (1988). "Actual malice" has been defined as:

> (1) that state of mind under which a person's conduct is characterized by hatred, ill will or a spirit of revenge, or (2) a conscious disregard for the rights and safety of other persons that has a great probability of causing substantial harm.

Ibid, citing *Preston v. Murty*, 32 Ohio St.3d 334, 512 N.E.2d 1174 (1987).

Applying this standard to the present case this Court believes that the evidence regarding the interaction between representatives of the defendant, including consultation with counsel, pertaining to Mor-Flo's request for coverage in the underlying suit, coupled with the lack of Ohio precedential authority on the critical issues concerning interpretation of the policy language when the denials of coverage were made, negates plaintiff's contention that the insurer's decision was made without reasonable justification. Having found no breach of the duty to act in good faith there would be no reason to address the issue of actual malice.[8]

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8. If such an analysis was undertaken this Court would not find that any representative of the insurer acted with hatred, ill will or a spirit of revenge and, for the same reasons as precluded a finding of bad faith, could not find that the insurer acted with such a conscious disregard for the rights and safety of Mor-Flo that there was a great probability of causing substantial harm.

Appendix C

In summary, this Court hereby recommends that Your Honor: (1) grant the plaintiff's motion for summary judgment on the issues of duty to defend and entitlement to attorneys' fees, expenses and costs incurred in the instant case, and directing that further submissions be made addressing the amounts of fees, expenses and costs to be awarded; (2) withhold judgment on the issue of entitlement to prejudgment interest until supplemental submissions have been made; (3) deny the plaintiff's motion on the remaining issues; (4) deny the defendant's motion for summary judgment on the issues of duty to defend and entitlement to attorneys' fees, expenses and costs incurred in the instant case; and (5) grant the defendant's motion on the remaining issues.

s/ David Perelman
DAVID S. PERELMAN
United States Magistrate Judge

DATE: May 27, 1998

OBJECTIONS

APPENDIX D — MEMORANDUM AND ORDER OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF OHIO, EASTERN DIVISION DATED AND FILED NOVEMBER 10, 1992

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

CASE NO.: 1:92CV1747

HON. GEORGE W. WHITE

WALTER L. ABT

Plaintiff,

v.

ST. PAUL FIRE AND MARINE
INSURANCE COMPANY

Defendants.

MEMORANDUM AND ORDER

This is a diversity action regarding the rights and obligations of defendant St. Paul Fire and Marine Insurance Company (St. Paul) concerning liability coverage, duty to defend and obligation to indemnify as to certain policies issued by St. Paul to Mor-Flo Industries and allegedly assigned to plaintiff, Walter Abt. The complaint was filed on August 25, 1992. The return of service was filed on September 9, 1992 showing that service was obtained on

defendant on August 27, 1992. The answer to the complaint was due on September 16, 1992. No answer was filed by that date so plaintiff applied for entry of default on the next day. On that day, September 17, 1992, the Clerk of Court entered the default. On September 28, 1992 default judgment was entered for $15,491.016.00 together with interest of 10% from September 21, 1992. This matter is before the Court upon defendant's motion to vacate the judgment pursuant to Rule 60(b) of the Federal Rules of Civil Procedure filed on October 8,1992. Subsequently, the Court granted defendant's motion to stay execution of the judgment.

The defendant has appealed the Court's entry of default judgment. Generally, when an appeal is filed the district court has no further jurisdiction over the action. However, the Sixth Circuit has ruled that a district court may consider the merits of a Rule 60(b) motion. *First National Bank v. Hirsch*, 535 F.2d 343 (6th Cir. 1976). If the district court intends to grant this motion, it must enter an order indicating its intention and the movant can then move the Court of Appeals to remand the action. *Id.* at 346. *Flynt v. Brownfield, Bowen & Bally*, 726 F. Supp 1106, 1108 (S.D. Ohio 1989). When the action is remanded the district court can grant the Rule 60(b) motion. A ruling denying the Rule 60(b) motion can be made while an appeal is pending. *Id.* See *Schewchun v. Edwards*, 815 F.2d 79 (6th Cir. 1987). The parties have agreed that the above constitutes the law on this issue. The defendant has moved to vacate the default judgment pursuant to Rule 60(b)(1) and (3). Rule 60(b) provides in pertinent part:

> On motion and upon such terms as are just, the court may relieve a party or a parts legal representative

> from a final judgment, order, or proceeding for the following reasons: (1) mistake, inadvertence, surprise, or excusable neglect; (3) fraud (whether heretofore denominated intrinsic or extrinsic), misrepresentation, or other misconduct of an adverse party.

Under Rule 55(c) of the Federal Rules of Civil Procedure the Court may set aside an entry of default for good cause shown but if judgment has been entered Rule 60(b) must be used. Rule 60(b) must be applied equitably and liberally. *United Coin Meter Co. v. Seaboard Coastline Railroad*, 705 F.2d 839, 845 (6th Cir. 1983). Judgment by default is a drastic step to be used in extreme cases. *Id.* at 845. Where a default results from an honest mistake and not from willful misconduct, recklessness or negligence, Rule 60(b) should be liberally applied. *Id.* at 845.

The Sixth Circuit uses the same three factors for determining whether an entry of default or default judgment should be vacated. *United Coin Meter Co. v. Seaboard Coastline Railroad*, 705 F.2d at 845. These factors are:

1) Whether the plaintiff will be prejudiced.

2) Whether the defendant has a meritorious defense.

3) Whether culpable conduct of the defendant led to the default. *Id.* at 845.

There is nothing in the record of this to case to indicate that plaintiff will be prejudiced from reinstatement of this

case. The application for default and entry of judgment occurred within a matter of days after the answer date. The motion to vacate was filed shortly thereafter. There will not be any delay, loss of evidence, or increased difficulties of discovery if the motion to vacate is granted. A meritorious defense is presented if it is a defense good at law. *United Coin Meter Co. v. Seaboard Coastline Railroad*, 705 F.2d at 845. Likelihood of success on the merits is not necessary. *Id.* at 845. The issue in this case is whether plaintiff is covered for a judgment obtained against Mor-Flo in a patent infringement case. St. Paul explained to Mor-Flo in a letter dated November 7, 1991 why it declined to cover it. It was asserted that the terms of the policy did not cover the allegations of the complaint. Defendant cites two cases that appear favorable. *St. Paul Mercury Ins. Co. v. Capitol American Life Insurance Co.*, No. 1:90CV1357 (N.D. Ohio Jan 6, 1992) and *Bank of the West v. Superior Court of Contra Cocta County*, 2 Col. 4th 1254, 1992 W.L. 181307 (Supreme Court of Cal, 1992). In addition, there is an issue as to whether Plaintiff, Walter Abt, has standing to bring this lawsuit due to provisions of the policy prohibiting assignments without consent of St. Paul.

Finally, the Court must consider whether culpable conduct of the defendant led to the default. Culpable conduct means conduct by defendant with an intent to thwart judicial proceedings or a reckless disregard for the effect of the conduct on the proceedings. *Shepard Claims Service Inc. v. William Darrah & Associates*, 796 F.2d 190, 194 (6th Cir. 1986). Defendant's conduct which resulted in default did not constitute an intent to thwart judicial proceedings nor did it amount to a reckless disregard for the effect of the conduct

on the proceedings. It appears that St. Paul forwarded the complaint to its attorneys within a reasonable time after service. The law firm made a good faith effort to determine the date of service from the Clerk of Court, apparently, mistakenly relying on plaintiff's return of service. There is nothing in the Federal Rules of Civil Procedure or Local Court Rules requiring the return of service to be filed within a certain time. It may be filed months later. Meanwhile, the time to answer will have expired. But plaintiff, although within the rules, wasted no time whatsoever in applying for default judgment. His attorneys knew that St. Paul had been represented by Attorney John Baker who would most likely not intentionally allow such a large default judgment be taken against his client. The Court in *United Coin Meter* stated:

> "Trials on the merits are favored in federal courts and a 'glaring abuse' of discretion is not required for reversal of a court's refusal to relieve a party of the harsh sanction of default."

705 F.2d at 846. Any doubt should be decided in favor of setting aside the default. *Id.*

Accordingly, the Court certifies that it intends to grant defendant's motion to vacate the default judgment if the action is remanded by the Sixth Circuit Court of Appeals.

IT IS SO ORDERED.

s/ George W. White
George W. White
UNITED STATES DISTRICT JUDGE

APPENDIX E — ORDER OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF OHIO, EASTERN DIVISION DATED AND FILED JANUARY 12, 1993

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

CASE NO.: 1:92CV1747

HON. GEORGE W. WHITE

WALTER L. ABT,

Plaintiff,

v.

ST. PAUL FIRE AND MARINE INSURANCE COMPANY,

Defendants.

ORDER

On November 10, 1992 this Court ruled that it would grant defendant's motion to vacate the default judgment if the action was remanded by the Sixth Circuit Court of Appeals. The Sixth Circuit Court of Appeals remanded this action to this Court on December 22, 1992.

Accordingly, defendant's motion to vacate the default judgment pursuant to Rule 60(b) is granted. The action is ordered reinstated.